Supreme Court, U. S.
FILED
MAY 5 1978
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; and MORTGAGE TRUST OF AMERICA,

Petitioners,

vs.

HARRY LEWIS,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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(continued)

May 4, 1978

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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; and MORTGAGE TRUST OF AMERICA,

Petitioners,

vs.

HARRY LEWIS,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

---

Petitioners, Transamerica Mortgage Advisors, Inc. (TAMA), Kent L. Colwell, J. Wendell Coombs, John R. Jensen, Ralph D. Wenger, John Havens, Transamerica Corporation, Transamerica Land Capital, Inc., and Mortgage Trust of America, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered on April 19, 1978.

OPINIONS BELOW

The opinion of the Court of Appeals (A1-A5)[1] has not yet been reported. The applicable orders of the District Court (A6-A9) are not reported.

The majority and dissenting opinions of the Court of Appeals adopt the majority and dissenting opinions of the Court of Appeals for the Second and Fifth Circuits in *Abrahamson v. Fleschner,* 568 F.2d 862 (2d Cir. 1977), and *Wilson v. First Houston Investment Corp.,* 566 F.2d 1235 (5th Cir. 1978), respectively. The opinions in *Abrahamson* are set forth in the appendix to this petition at A10-A57. The opinions in *Wilson* are set forth at A58-A76.

A petition for certiorari has been filed in the *Abrahamson* case and is before this Court as Dkt. No. 77-1279.

JURISDICTION

The judgment of the Court of Appeals was entered on April 19, 1978. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

May a private right of action be implied under the Investment Advisers Act of 1940?

STATUTES INVOLVED

Section 206 of the Investment Advisers Act of 1940, 54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. §§ 80b-6; and Section 214 of that Act, 54 Stat. 856, 15 U.S.C. § 80b-14. are set forth in the appendix to this petition at A50-A51.

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1. All "A...." page references are to the appendix to this petition.

STATEMENT OF THE CASE

The petitioners include four corporate or trust entities—Transamerica Mortgage Advisors, Inc. (TAMA); Transamerica Corporation; Transamerica Land Capital, Inc.; and Mortgage Trust of America.

The five individual petitioners are trustees of Mortgage Trust of America, an independent real estate investment trust. The Trust has nine trustees. A majority of the trustees have always been independent of Transamerica and its subsidiaries.

Mortgage Trust of America—Mortgage Trust of America is qualified as a real estate investment trust under applicable provisions of the Internal Revenue Code. The Trust's business is limited to investments in real estate—primarily construction and development first mortgage loans. None of the Trust investments have ever been listed on any national or local securities exchange, or offered for trading in any over-the-counter markets.

Transamerica Mortgage Advisors, Inc. (TAMA)—TAMA is retained by Mortgage Trust of America as its adviser. The Trust is TAMA's only client. TAMA advises the Trust on various real estate investments and administers the Trust's day-to-day operations. TAMA has never had another client. TAMA has never advertised its services, solicited additional clients, or held itself out in any way as a public investment adviser.

The Litigation—The respondent filed suit in the United States District Court for the Southern District of New York in April, 1973. Jurisdiction was said to be based on the Investment Advisers Act of 1940. (15 U.S.C. §§ 80b-1, *et seq.*) The complaint sets forth six claims for relief. The first three are derivative and the last three purport to be class actions on behalf of Mortgage Trust of America's

shareholders. The first (derivative) and fourth (class) claims allege that defendants TAMA and Transamerica Corporation failed to register in accord with the Investment Advisers Act, and that certain fees paid to TAMA by the Trust were excessive. The second (derivative) and fifth (class) claims allege unfairness and conflicts of interest in the Trust's purchase of its initial loan portfolio from Transamerica Land Capital. The third (derivative) and sixth (class) claims allege breach of fiduciary duty and breach of trust by TAMA and Transamerica Corporation in rendering investment advice to Mortgage Trust of America.

Pursuant to stipulation, the case was transferred to the Northern District of California in December, 1973. In March, 1974, the petitioners joined in asking that the case be dismissed. They argued, *inter alia*, that the Investment Advisers Act of 1940 did not afford a private right of action. The district court agreed, and a formal order dismissing the complaint with leave to amend was entered in October, 1974. (A6-A7). The respondent declined to amend, and the case was dismissed with prejudice in November 1974. (A8-A9). The respondent appealed. On April 19, 1978, the Court of Appeals (2-1; Wallace, J., dissenting) held that "the implication of a private right of action for injunctive relief and damages under the [Investment Advisers Act] in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation." (A4).

In dissent, Judge Wallace stated: "This case presents an issue of first impression in our circuit on which reasonable minds may differ. I recognize the strength of the opinions and the articles cited by the majority. I am persuaded, however, by the analysis of Judge Gurfein in *Abrahamson v. Fleschner*, 568 F.2d 862, 879 (2d Cir. 1977) (concurring and dissenting) and therefore respectfully dissent." (A5).

REASONS FOR GRANTING THE WRIT

This case presents the same important question of law as that presented in *Abrahamson v. Fleschner*, 568 F.2d 862, 879 (2d Cir. 1977), now before this Court on petition for certiorari as *Fleschner v. Abrahamson*, Dkt. No. 77-1279. Rather than repeat the reasons why a writ should issue here, we respectfully refer the Court to the petition for certiorari filed in *Abrahamson*, and specifically pages 7-15.

In addition, we urge special attention to the following:

(1) No court of appeals has implied a right of action under the Investment Advisers Act without forceful dissent. Judge Gurfein's dissent in the *Abrahamson* case, adopted by Judge Wallace in the Court below and by Judge Hill in *Wilson v. First Houston Investment Corp., supra*, calls attention to the fact that implying a private right of action "circumvents the sound policies behind restrictions on 10b-5 claims." (A51-A52). Indeed, implying a private right of action under the Advisers Act scuttles the limitations on securities law actions recognized in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). The Congress has had four opportunities to provide a private right of action under the Advisers Act and has declined to do so. *See, Fleschner v. Abrahamson*, Dkt. No. 77-1279, Petition for a Writ of Certiorari, dated March 14, 1978, at pages 11-14. Nevertheless, the majority in the Second, Fifth and Ninth Circuits have uncovered an unspoken private legal right—an implied right that is neither necessary nor prudent.

(2) Implying a private right of action under the Investment Advisers Act imposes an unnecessary burden on the federal courts. Actions such as this, alleging breach of

fiduciary duty and fraud, are a mainstay of state court litigation—legal actions "traditionally relegated to state law, in an area basically the concern of the States . . ." *Cort v. Ash,* 422 U.S. 66, 78 (1975).

The burden on the federal courts is more than an abstract possibility. There are 218 real estate investment trusts in the United States.[2] The respondent here is the plaintiff in at least two other federal actions against real estate investment trusts and their advisers. *See, Lewis v. Diversified Mortgage Investors,* U.S.D.C., S.D.N.Y., No. 75 Civ-1001; *Lewis v. Capital Mortgage Investments,* U.S.D.C., D. Md., No. N75-1094. The complaint in the *Diversified Mortgage* case is virtually identical to the complaint filed in this case.[3] Other plaintiffs in complaints essentially identical to the complaint filed in this case have alleged violation of the Advisers Act against real estate investment trusts and their advisers.[4]

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2. REITs Monthly, April 1978, at 1 (published by the National Association of Real Estate Investment Trusts, 1101 Seventeenth St., N.W., Washington, D.C. 20036).

3. The respondent here was also the plaintiff in another action against a real estate investment trust and its adviser. *See, Lewis v. Guardian Mortgage Investors,* U.S.D.C., M.D. Fla., No. 73-851-Civ-JT (settled).

4. *See, Uttrich v. Lomas & Nettleton Mortgage Investors,* U.S. D.C., D. Conn., No. Civ-15704 (case withdrawn); *Lerman v. ATICO Advisory Corp.,* U.S.D.C., S.D. Fla., No. 73-1172-Civ-JE (dismissal affirmed on appeal); *Greenspan v. First Mortgage Investors,* U.S.D.C., S.D. Fla., No. 73-638-Civ-JE (dismissed); *Greenspan v. Continental Mortgage Investors,* U.S.D.C., D. Mass., No. 72-1160 T (settled); *Jones v. Equitable Life Assurance Society,* CCH Fed. Sec. L. Rep. 97,402, ¶ 94,986, U.S.D.C., S.D.N.Y. (1975) (dismissed); *Kreindler v. Citizens Mortgage Investment Trust,* U.S. D.C., S.D.N.Y., No. 73-Civ-1623 (settled); *Kramer v. Massachusetts Mutual Mortgage & Realty Investors,* U.S.D.C., S.D.N.Y., No. 73-Civ-1306 (settled); *Mayer v. Chase Manhattan Mortgage and Realty Trust, U.S.D.C., S.D.N.Y.,* No. 72-Civ-1623 (settled); *Schreiber v. Northwestern Mutual Life Mortgage Realty Investors,* U.S.D.C., E.D. Wisc., No. 73-Civ-1056 (case withdrawn).

(3) Finally, interpretation of the Investment Advisers Act has led to a classic confrontation between the express words of a statute and the statute's assumed purpose. The Court of Appeals has adopted an assumed purpose, and like the majority in *Wilson v. First Houston Investment Corp., supra,* has "found that a private right of action exists where the United States Congress has failed to provide for one." (A73). This petition, then, presents a case in which the meaning of a statute has been derived, not from specific language, but from an assumption of what ought to be. "At best this is subtle business," Justice Frankfurter once warned, "calling for great wariness lest what professes to be mere rendering becomes creation and attempted interpretation of legislation becomes legislation itself." *Palmer v. Massachusetts,* 308 U.S. 79, 83 (1939).

CONCLUSION

For the reasons set forth in the petition for certiorari filed in *Fleschner v. Abrahamson,* Dkt. No. 77-1279, and for the foregoing reasons, a writ of certiorari should issue to the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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Counsel for Petitioner,
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May 4, 1978

(Appendix follows)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FILED
April 19, 1978
EMIL E. MELFI, JR.
Clerk, U.S. Court of Appeals

No. 75-1285
OPINION

HARRY LEWIS,
Plaintiff-Appellant,

v.

TRANSAMERICA CORP., et al.,
Defendants-Appellees.

Appeal from the United States District Court
For the Northern District of California

Before: BROWNING and WALLACE, Circuit Judges, and EAST,* Senior District Judge

EAST, Senior District Judge:

The plaintiff-appellant Harry Lewis (Lewis) appeals from an order entered by the District Court on November 21, 1974 dismissing the action with prejudice on the grounds "Section 206 of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-6) [Advisers Act] affords no private right of action, and that consequently the Court has no jurisdiction of the plaintiff's claims . . . ." We vacate the order and remand.

*Honorable William G. East, Senior United States District Judge for the District of Oregon, sitting by designation.

Lewis' Complaint:

Lewis is a shareholder of the defendant-appellee Mortgage Trust of America (Trust), and his complaint presents three shareholder derivative and three class actions for violation of the Advisers Act and common law fiduciary duties. He alleges in substance:

The Trust was organized as a California business trust and is qualified as a real estate investment trust under the Internal Revenue Code. It invests primarily in construction and development first mortgage loans. None of its investments have been listed on any national or local securities exchange or offered for trading in any over-the-counter market. The original officers and employees of the Trust were formerly associated with the defendant-appellee Transamerica Land Capital, Inc. (TALC), a "first tier" subsidiary of the defendant-appellee Transamerica Corp. (Transamerica). The Trust purchased from TALC its original portfolio of mortgages. The defendant-appellee Transamerica Mortgage Advisors, Inc. (Mortgage Advisors), a Delaware corporation and a "third tier" subsidiary of Transamerica, is retained as the Trust's mortgage adviser. It advises the Trust on various real estate investments and administers its day-to-day operations. The Trust is and always has been Mortgage Advisors' only client. Transamerica is the parent of Mortgage Advisors and the sponsor of the Trust. Nine individual defendants-appellees are trustees of the Trust.

Lewis' Issue on Review:

Does the Advisers Act give rise to an implied private right of action for injunctive relief and damages on behalf of persons injured by violations of its provisions?

Defendants-Appellees' Issues on Review:

In view of the naked holding of a lack of jurisdiction, the District Court did not reach the following issues which the defendants present for review:

(1) Whether the several defendants fall within the scope of the Advisers Act.

(2) Whether the class action claims are proper.

(3) Whether Lewis has standing to maintain a derivative action without having made a demand upon the trustees to act.

Discussion:

Since the District Court did not first consider and adjudicate those issues raised by the defendants, we decline to now do so. *Singleton v. Wulff*, 428 U.S. 106, 120 (1976); *Hector v. Wiens*, 533 F.2d 429, 433 (9th Cir. 1976).

At the time of the District Court's consideration of its ultimate order of dismissal of the action for lack of jurisdiction, the circuit case law on the issue was nil. At that time only the following District Court decisions were available for consideration: *Bolger v. Laventhol, Krekstein, Horwarth & Horwarth*, 381 F.Supp. 260, 263 (S.D.N.Y. 1974) (recognizing an implied private right of action). *Greenspan v. del Toro*, No. 73-638 CIV JE (S.D. Fla. May 17, 1974), *appeal dismissed for want of prosecution*, No. 74-2943 (5th Cir. Sept. 5, 1974); and *Gammage v. Roberts, Scott & Co.*, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,761 (S.D. Cal. 1974) (no private right of action).

We now have the benefit of the decisions of the Courts of Appeals for the Fifth and Second Circuits finding an implied private right of action under the Advisers Act. *Wilson v. First Houston Investment Corp.*, [Current] Fed.

Sec. L. Rep. (CCH) ¶ 96,311 (Feb. 2, 1978); *Abrahamson v. Fleschner,* [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,889 (2d Cir. Feb. 25, 1977).[1]

Without reiterating their able discussions, we adopt the rationale of the majorities in *Abrahamson* and *Wilson.* Accordingly, we hold that the implication of a private right of action for injunctive relief and damages under the Advisers Act in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation. The District Court holds subject matter jurisdiction to entertain such actions and pendens state claims pursuant to 28 U.S.C. § 1331.[2]

The District Court's order of dismissal is vacated and the cause remanded to the District Court for further proceedings consistent herewith.

ORDER OF DISMISSAL VACATED AND CAUSE REMANDED.

Lewis v. Transamerica Corp.

No. 75-1285

WALLACE, Circuit Judge, Dissenting:

This case presents an issue of first impression in our circuit on which reasonable minds may differ. I recognize the strength of the opinions and the articles cited by the majority. I am persuaded, however, by the analysis of Judge Gurfein in *Abrahamson v. Fleschner,* 568 F.2d 862, 879 (2d Cir. 1977) (concurring and dissenting), and therefore respectfully dissent.

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1. See the following for support of the majorities' rationale in *Abrahamson* and *Wilson: J. I. Case Co. v. Borak,* 377 U.S. 426 (1964); *Cort v. Ash,* 422 U.S. 66, 78 (1975); and *Bolger's* clarifying discussion of the goal of Congress in enacting the Advisers Act, 381 F.Supp. at 263.

The following District Courts have, since the entry of the order of dismissal in this case, held that an implied right of private action exists under the Advisers Act: *Jones v. Equitable Life Assurance Society,* 409 F.Supp. 370 (S.D.N.Y. 1975), *accord, Angelakis v. Churchill Management Corp.,* [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,285 (N.D. Cal. 1975); and *Sullivan v. Chase Investment Services of Boston, Inc.,* [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,224 (N.D. Cal. 1977).

The Securities Exchange Commission has submitted to Congress a proposed amendment to the Advisers Act which provides explicitly for a private right of action under the Advisers Act. See Investment Advisers Act Release No. 491, 8 SEC Docket 744 (Dec. 15, 1975). In announcing its proposal, the SEC repeated its view that the existing language was sufficient to imply a private right of action. Its proposal was intended to put to rest those few decisions which have found no implied right of action. "The commentators who have reviewed these decisions agree that a private right of action should be implied under the Advisers Act. Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich. L. Rev. 308 (1975); Lybecker, Advisers Act Developments, 8 Review of Securities Regulations 927, 934 (April 23, 1975); Note, *Bolger v. Laventhol, Krekstein, Horwarth & Horwarth: Private Rights of Action Under the Investment Advisers Act,* 48 Temple L.Q. 433 (1975)." *Abrahamson* at 91,282 n.17.

2. "The trial court stated that it was dismissing for lack of subject matter jurisdiction. According to the district court's analysis, the complaint more properly should have been dismissed for failure to state a claim upon which relief can be granted. *See Mobil Oil Corp. v. Kelley,* 493 F.2d 784, 786 (CA5), *cert. denied,* 419 U.S. 1022, 95 S. Ct. 498, 42 L.Ed.2d 296 (1974). As pertains to the asserted cause of action under the IAA, general federal question jurisdiction is conferred by 28 U.S.C. § 1331 (1970). *See Abrahamson v. Fleschner,* No. 75-7203, ... F.2d ....., at ..... n.5 (CA2 1977) (the dissent and majority agree on this point)." *Wilson* at 93,040 n.2.

ORIGINAL

FILED

OCT 7 1974

CLERK, U. S. DIST. COURT

SAN FRANCISCO

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

No. C 73-2180 RHS
ORDER

HARRY LEWIS,

Plaintiff,

vs.

TRANSAMERICA CORPORATION,
et al.,

Defendants.

The motion of defendants, Transamerica Mortgage Advisors, Inc., et al., to dismiss; and the motions of defendants Transamerica Corporation, Transamerica Land Capital, Inc., and Mortgage Trust of America, to dismiss or, in the alternative, for summary judgment and for a more definitive statement, came on for hearing on Friday, September 27, 1974.

The plaintiff, Harry Lewis, was represented by Francis J. McTernan, Esq., and Messrs. Garry, Dreyfus, McTernan, Brotsky, Herndon & Pesonen of San Francisco. The defendants, Transamerica Mortgage Advisors, Inc., J. Wendell Coombs, Ralph D. Wenge, Kent L. Colwell and John R. Jensen, were represented by John M. Anderson, Esq., and

Messrs. Landels, Ripley & Diamond of San Francisco. The defendants, Transamerica Corporation and Transamerica Land Capital, Inc., were represented by Joseph Martin, Jr., Esq., and Messrs. Pettit, Evers and Martin of San Francisco. The defendant, Mortgage Trust of America was represented by Jon F. Hartung, Esq., and Messrs. Farella, Braun & Martel of San Francisco. Defendant, John F. Havens was represented by Neil L. Shapiro, Esq., of Messrs. Cooper, White & Cooper of San Francisco.

The Court having received and considered written memoranda from the parties in support of and in opposition to the above-described motions; having heard oral argument, and having considered the affidavits, pleadings and other papers on file in this case, makes the following:

ORDER:

1. The Court having determined that since Section 206 of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-6) affords no private right of action, and that consequently the Court has no jurisdiction of the plaintiff's claims, the defendants' motion to dismiss is *granted*.

2. The alternate motions of defendants Transamerica Corporation, Transamerica Land Capital, Inc., and Mortgage Trust of America for summary judgment or for a more definite statement, having become moot by reason of the foregoing order, are *denied* without prejudice.

3. Plaintiff may have 45 days from September 27, 1974, within which to file an amended complaint. If the plaintiff does not file an amended complaint within the foregoing period, then this case shall be dismissed pursuant to Rule 41(b) of the Federal Rules of Civil Procedue.

Dated: Oct 7 1974

ROBERT H. SCHNACKE
UNITED STATES DISTRICT JUDGE

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FILED
NOV 21 1974

CLERK, U. S. DIST. COURT
SAN FRANCISCO

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

No. C 73-2180 RHS
ORDER

HARRY LEWIS
Plaintiff,

vs.

TRANSAMERICA CORPORATION,
et al.,
Defendants.

WHEREAS, the motion of defendants, Transamerica Mortgage Advisors, Inc., *et al.*, to dismiss; and the motions of defendants Transamerica Corporation, Transamerica Land Capital, Inc., and Mortgage Trust of America, to dismiss, or, in the alternative, for summary judgment and for a more definite statement, came on for hearing on Friday, September 27, 1974; and

WHEREAS, and pursuant to an order dated and filed October 7, 1974, this Court granted the motion of defendants, Transamerica Mortgage Advisors, *et al.*, to dismiss, but allowing the plaintiff 45 days from September 27, 1974, within which to amend; and

WHEREAS, the plaintiff, Harry Lewis, has failed to amend his complaint within the time allowed, or at all, the court makes the following

ORDER

Pursuant to Fed. R. Civ. P. 41(b), this case is dismissed with prejudice as against each and all of the defendants, and each and all of the defendants are awarded their respective costs.

Dated: Nov 21 1974

ROBERT H. SCHNACKE
UNITED STATES DISTRICT JUDGE

Robert ABRAHAMSON and Marjorie Abrahamson, Plaintiffs-Appellants,

v.

Malcolm K. FLESCHNER et al., Defendants-Appellees.

No. 212, Docket 75-7203.
United States Court of Appeals,
Second Circuit.
Submitted Feb. 28, 1976*.
Decided Feb. 25, 1977.
Rehearing En Banc Unanimously Denied Jan. 6, 1978.

Ronald H. Alenstein, New York City (Kenneth A. Barry, and Shea, Gould, Climenko, Kramer & Casey, New York City, on the brief), for plaintiffs-appellants Robert Abrahamson and Marjorie Abrahamson.

Richard E. Carlton, New York City (Robert D. Owen, James E. Tyrrell, and Sullivan & Cromwell, New York City, on the brief), for defendants-appellees Malcolm K. Fleschner, William J. Becker and Fleschner Becker Associates.

Richard G. McGahren, New York City (Kenneth A. Sagat, and D'Amato, Costello & Shea, New York City, on the brief), for defendant-appellee Harry Goodkin & Co.

Mark M. Jaffe, New York City (Allan J. Berdon, Joseph F. Aman, and Hill, Betts & Nash, New York City, on the brief), for defendant-appellee Harold B. Ehrlich.

Harvey L. Pitt, Gen. Counsel, Paul Gonson, Associate Gen. Counsel, David J. Romanski, Asst. Gen. Counsel, James H. Schropp, Atty., SEC, Washington, D. C., for Securities and Exchange Commission, amicus curiae.

Before MANSFIELD, TIMBERS and GURFEIN, Circuit Judges.

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*See our interim opinion in this case. *Abrahamson v. Fleschner*, 537 F.2d 27 (2 Cir. 1975).

TIMBERS, Circuit Judge:

Of the several questions presented under the antifraud provisions of the federal securities laws, those under the Investment Advisers Act of 1940 appear to be of first impression at the appellate level.*

The appeal is from a judgment entered in the Southern District of New York, Robert L. Carter, *District Judge*, 392 F.Supp. 740, dismissing the complaint, on cross-motions for summary judgment, in an action to recover damages for alleged violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and of Rule 10b-5 thereunder, 17 C.F.R. § 240-10b-5 (1976); and alleged violations of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1970), and of Rule 206(4)-1 thereunder, 17 C.F.R. § 275.206(4) (1976).

The essential questions presented and our rulings thereon are as follows:

(1) Whether the complaint states a claim upon which relief can be granted under Section 10(b) of the 1934 Act and Rule 10b-5.

We hold it does not.

(2) Whether defendants who are general partners of the investment partnership are investment advisers within the meaning of Section 202(a)(11) of the Advisers Act.

We hold they are.

(3) Whether there is an implied private right of action for damages under the Advisers Act.

We hold there is.

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*We note that about the time our Court unanimously denied rehearing en banc in the instant case the Fifth Circuit held that there is an implied right of action for damages under § 206 of the Advisers Act. *Wilson v. First Houston Investment Corp.*, ... F.2d ..... (5th Cir. 1978), 46 U.S.L.W. 2429 (U.S. Fed. 1978).

(4) Whether the complaint alleges compensable damages under the Advisers Act.

We hold it does.

(5) Whether the complaint states a claim upon which relief can be granted under Section 206 of the Advisers Act and Rule 206(4)-1.

We hold it does.

We affirm the dismissal of the Exchange Act claim; but as to the dismissal of the Advisers Act claim, we reverse and remand for trial.

I. FACTS

The following summary of the essential facts is believed necessary to an understanding of our rulings on the questions presented.[1] The facts are not in dispute.

Plaintiffs Robert Abrahamson and Marjorie Abrahamson, husband and wife, were limited partners of defendant Fleschner Becker Associates (FBA), an investment partnership, from its inception on July 1, 1965 until they withdrew on September 30, 1970.

Defendants Malcolm K. Fleschner (Fleschner) and William J. Becker (Becker) are general partners of FBA. Fleschner was its founder and has been a general partner since its inception. Becker became a general partner on April 1, 1966. Defendant Harold B. Ehrlich (Ehrlich) was a general partner from October 1, 1968 through September 30, 1969. Defendant Harry Goodkin & Company (Goodkin) is a firm of certified public accountants which audited FBA's books and certified FBA's financial reports for the fiscal years 1966, 1967 and 1968.

In late 1964 and in 1965 plaintiffs had several conversations with Fleschner who expressed his intention of forming

1. We assume familiarity with our prior opinion in this case, 537 F.2d 27, and that of the district court, 392 F.Supp. 740.

an investment partnership. He told plaintiffs that the partnership would have a conservative investment policy. Plaintiffs expressed their concern for financial security and conservatism in their investments.

By a partnership agreement dated July 1, 1965, FBA began as a small partnership. The original partners consisted of one general partner (Fleschner) and eight limited partners (plaintiffs, four members of Fleschner's family and two others). Plaintiffs' initial contribution was $150,000.

FBA grew rapidly. By April 1, 1966 it had two general partners and thirty-five limited partners, and by October 1, 1968 it had three general partners and sixty-six limited partners. Each partner had an account which represented the appreciated value of his contributions to the pooled funds, less withdrawals and certain fees. By October 1, 1968 FBA's assets were approximately $60 million.

For managing the partnership investments, the general partners received substantial fees. They were paid 20% of FBA's net profits and net capital gains for each fiscal year. In addition, the partnership agreement of October 1, 1968 provided for an annual salary of $25,000 for each general partner who managed the partnership's investments.

The limited partners did not participate in managing the partnership's investments. A limited partner could withdraw all or part of the balance in his capital account at the end of any fiscal year (September 30), provided that he gave the required advance notice. Prior to October 1, 1968, 30 days notice was required; thereafter, 60 days notice was required. There were similar notice requirements for withdrawal from membership in the partnership.

With the increase in the number of limited partners and the concomitant increase in the size of the firm's assets, certain changes were made in the structure of the partner-

ship. The original July 1, 1965 partnership agreement was superseded by a new agreement dated April 1, 1966 which in turn was superseded by the October 1, 1968 agreement. The principal change effected by the 1966 agreement was the addition of Becker as a general and managing partner and the inclusion of additional limited partners. The 1968 agreement, in addition to authorizing salaries of $25,000 per year for those general partners who managed the partnership's investments, included Ehrlich as a general partner; added a large number of limited partners; expanded and detailed the stated purposes of the partnership; and made a number of other changes referred to below.

During the period plaintiffs were limited partners of FBA the general partners mailed monthly reports to all of the firm's limited partners. These reports were concise, two paragraph statements which set forth the percentage increase or decrease in the value of the firm's investments for the year to date and compared this performance with Standard & Poor's 500 Stock Average.

The reports also included statements of the firm's investment policy. Between November 1967 and April 1968 the reports repeatedly represented that FBA was maintaining a "low risk stance" and "a most conservative posture."[2]

In addition to the monthly reports, during 1967 and 1968 Goodkin mailed to the limited partners certified year end financial reports. These financial reports included balance sheets which showed the total of FBA's investments in securities. The balance sheets of September 30, 1967 and September 30, 1968 did not disclose that the firm was investing in unregistered securities.[3] Investments in such securities were included in the aggregate of all portfolio investments. The value of FBA's total investments in securities was denominated as the "market value" of the securities.

2. For examples of these representations in the monthly reports, see the district court opinion, 392 F.Supp. at 742 n.2.

3. Unregistered securities are securities which are not registered with the Securities and Exchange Commission. They have only a limited market and are subject to restrictions as to further sale.

Despite the representations in the monthly reports that FBA's investments were most conservative and of low risk, between September 1967 and September 1968 the firm increased its investments in unregistered securities from approximately 15% to approximately 72% of its portfolio. Between September 1968 and September 1969 the firm's investments in unregistered securities fluctuated from about 72% to 88% of its portfolio.[4] During this latter period the monthly reports continued not to disclose the firm's sizable investments in unregistered securities.

In either December 1969 or January 1970 plaintiffs received the financial report for the fiscal year ending September 30, 1969. This report was not prepared by Goodkin, but by another accounting firm. A footnote to this report disclosed that approximately 77% ($30,411,868) of FBA's total investments in securities ($39,355,310) consisted of unregistered securities. The firm's total assets as of September 30, 1969 were $51,747,995.

Plaintiffs first learned of FBA's substantial investments in unregistered securities from the September 30, 1969 report. Having received this report in December 1969 or January 1970, it was too late for them to withdraw from the firm, in accordance with the partnership agreement, at the end of the fiscal year which ended September 30, 1969. Plaintiffs did withdraw at the end of the following fiscal

4. In their complaint in the instant action, plaintiffs alleged that during the period they were limited partners the firm made between 40 and 80 separate purchases of unregistered securities, including the securities of more than 40 different issuers. They alleged that most of these purchases took place after 1967.

year, on September 30, 1970. This was the earliest they could withdraw their investments or as partners under the terms of the partnership agreement.

During the five year period they were limited partners, both plaintiffs received substantial net profits.[5] Robert Abrahamson realized a net profit of $156,097; Marjorie Abrahamson a net profit of $133,081.35.

Both plaintiffs claim that as of late 1968 their investments were worth considerably more than indicated by the firm's financial reports, and that the firm incurred substantial losses on its investments in unregistered securities. Without apportioning between losses sustained from investments in unregistered securities and other losses,[6] Robert Abrahamson claims that between September 30, 1968 and the date of his withdrawal his capital account sustained losses totalling $454,979. Marjorie Abrahamson claims total losses of $799,821 during this period.

Plaintiffs commenced the instant action in the Southern District of New York on January 25, 1971. Jurisdiction was invoked under Section 27 of the Exchange Act, 15 U.S.C. § 78aa (1970), and Section 214 of the Advisers Act, 15 U.S.C. § 80b-14 (1970). The complaint embodies the claims stated above and summarized in our prior opinion. 537 F.2d 27.

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5. See the schedule set forth in the district court opinion, 392 F.Supp. at 743, showing plaintiffs' capital contributions, interim withdrawals, final distributive shares and net profits.

6. Plaintiffs claim that they are entitled to recover the difference between what they received when they withdrew from the partnership in 1970 and what they would have received had they withdrawn as of September 30, 1968. Accordingly they did not attempt an apportionment between losses attributable to excessive investments in unregistered securities and losses from unchallenged investments.

Both sides having moved for summary judgment, Judge Carter on March 4, 1975 filed an opinion, 392 F.Supp. 740, granting defendants' motions and denying plaintiffs' motion. Without reaching the merits of plaintiffs' claims under either the Exchange Act or the Advisers Act, the judge held that, since plaintiffs had realized a net profit on their overall five-year investments in FBA, they had failed to prove damages compensable under the federal securities laws. From the judgment entered March 27, 1975 dismissing the compliant, the instant appeal has been taken.

II. EXCHANGE ACT CLAIM

We need not tarry with plaintiffs' claim under Section 10(b) of the 1934 Act and Rule 10b-5 for we find that each of the arguments urged by plaintiffs in support of that claim is without merit.

[1, 2] First, in an effort to meet the requirement of Section 10(b) and Rule 10b-5 that they must allege a fraud "in connection with the purchase or sale of any security,"[7] plaintiffs argue that their interest in FBA was a "security" and that the modifications of the partnership agreement in 1968 constituted an exchange of one security for another.[8]

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7. This is the familiar provision of both Section 10(b) and Rule 10b-5. Obviously, the fraud alleged by plaintiffs was not "in connection with" either their initial investment in the partnership on July 1, 1965 or their withdrawal from the firm on September 30, 1970.

8. The principal modifications relied on by plaintiffs in their effort to show that the September 30, 1968 partnership agreement fundamentally changed the nature of their investment were: expansion of the general partners' authority to invest in other businesses and to make loans; authorization of $25,000 per year salaries for managing partners; shortening of the notice requirement for year end withdrawals of capital; provision for automatic termination of the partnership after ten years; and authorization for amendment of the partnership agreement by a vote of one-half of the limited partnership interests and two-thirds of the general partnership interests, rather than by the Executive Committee of the general partners as before.

In support of this theory, plaintiffs rely on cases which have held that significant modifications in the rights of security holders may constitute a "sale" of one security and "purchase" of another under Section 10(b) and Rule 10b-5, *Ingenito v. Bermec Corp.*, 376 F.Supp. 1154, 1179-82 (S.D.N.Y.1974); or a "sale" or "issue" of a security under the Public Utility Holding Company Act of 1935, *SEC v. Associated Gas & Elec. Co.*, 24 F.Supp. 899 (S.D.N.Y.), *aff'd*, 99 F.2d 795 (2 Cir. 1938); or an "issue" of stock under the Interstate Commerce Act, *United States v. New York, New Haven & Hartford R. Co.*, 276 F.2d 525 (2 Cir. 1959), *cert. denied*, 362 U.S. 961 (1960). We do not believe that this line of cases supports plaintiffs' claim in the instant case. Before changes in the rights of a security holder can qualify as the "purchase" of a new security under Section 10(b) and Rule 10b-5, there must be such significant change in the nature of the investment or in the investment risks as to amount to a new investment. We hold that the modifications effected by the adoption of a new partnership agreement on September 30, 1968 did not constitute the "purchase" and "sale" of new securities.

[3] Second, plaintiffs argue that they are entitled to recover under Section 10(b) and Rule 10b-5 because they were fraudulently induced not to sell their partnership interests. They say that they would have withdrawn from the firm in 1968 if defendants had not misrepresented the true nature of the firm's investments at that time. The short answer to this branch of plaintiffs' argument is that the requirement of fraud in connection with the purchase or sale of a security is not satisfied by an allegation that plaintiffs were induced fraudulently *not* to sell their securities. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737-38 (1975).

We affirm the dismissal of plaintiffs' Exchange Act claim.[9]

III. ADVISERS ACT CLAIM

We come next to what we consider to be the chief question presented on this appeal—whether the complaint states a claim upon which relief can be granted under Section 206 of the Investment Advisers Act of 1940 (the Act)[10] and Rule 206(4)-1 thereunder.[11]

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9. Our affirmance of the dismissal of the Exchange Act claim is on the ground that the complaint fails to state a claim upon which relief can be granted—not on the ground relied upon by the district court for dismissal, namely, that, since plaintiffs had realized a net profit on their overall limited partnership investment, they had failed to prove damages compensable under the federal securities laws. We shall discuss this ground of the district court decision under the Advisers Act claim, Section III, *infra*.

10. Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1970), in relevant part provides:

> "It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
>
> • • •
>
> (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4), by rules and regulations, define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

11. Rule 206(4)-1, 17 C.F.R. § 275.206(4)-1 (1976), in relevant part provides:

> "(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act, for any investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement:
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> • • •

The subordinate questions which we must consider in connection with this claim are (1) whether any of the defendant general partners are "investment advisers" within the meaning of Section 202(a)(11) of the Act,[12] (2) whether there is an implied private right of action for damages under the Act; and (3) whether plaintiffs have alleged compensable damages under the Act.

For the reasons below, we answer each of these questions in the affirmative. Accordingly, we reverse the dismissal of the Advisers Act claim and remand the case for trial on that claim.[13]

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(5) Which contains any untrue statement of a material fact, or which is otherwise false or misleading.

(b) For the purposes of this section the term 'advertisement' shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities."

12. Section 202(a)(11) of the Investment Advisers Act, 15 U.S.C. § 80b-2(a)(11) (1970), in relevant part provides:

"'Investment adviser' means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . . ."

13. It was the Advisers Act claim to which we invited the parties and the SEC as amicus curiae to address their supplemental briefs when we filed our interim opinion following oral argument of this appeal. 537 F.2d at 28. We express our appreciation for the helpful briefs from counsel for all parties and the SEC in response to our invitation.

(1) *"Investment Advisers" Under Section 202(a)(11)*

[4] Turning first to the threshold question whether any of the general partner defendants are "investment advisers" within the meaning of Section 202(a)(11), we hold that they are.

It is clear from the record that the general partners received substantial compensation for managing the limited partners' investments. Each of the three partnership agreements in effect between 1965 and 1970 provided that the general partners would be paid for their services 20% of the firm's net profits and net capital gains for each fiscal year. In addition, the partnership agreement of October 1, 1968 authorized an annual salary of $25,000 for each general partner who managed investments.

Since the general partners received compensation for their investment services, the only remaining inquiry under the statute is whether they were "engage[d] in the business of advising others" with respect to investments. On two independent grounds, we believe they were.

First, the monthly reports which contained the alleged fraudulent representations were reports which provided investment advice to the limited partners. The general partners' compensation depended in part upon the firm's net profits and capital gains. These in turn were affected by the size of the total funds under their control. The monthly reports were an integral part of the general partners' business of managing the limited partners' funds. In

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Likewise we invited the parties and the SEC as amicus curiae, in connection with appellees' petitions for rehearing, to file further supplemental briefs on the issue of whether the general partners of defendants Fleschner Becker Associates were investment advisers within the meaning of the Advisers Act (the issue dealt with below in section III(1) of this opinion). Such further supplemental briefs were filed and considered by us. The petitions for rehearing were denied and the panel opinions were adhered to.

deciding whether or not to withdraw their funds from the pool, the limited partners necessarily relied heavily on the reports they received from the general partners.

Second, wholly aside from the monthly reports, we believe that the general partners as persons who managed the funds of others for compensation are "investment advisers" within the meaning of the statute. This is borne out by the plain language of Section 202(a)(11) and its related provisions, by evidence of legislative intent and by the broad remedial purposes of the Act.

[5] The Investment Companies Act of 1940 and the companion Investment Advisers Act (Title II of the same enactment) were among statutes designed to eliminate certain abuses in the securities industry which were found to have contributed to the stock market crash of 1929 and the depression of the 1930s. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963). The 1940 legislation was based upon exhaustive studies by the SEC which culminated in a number of extensive reports on investment trusts, investment companies and investment advisers. The Investment Companies Act and the Advisers Act were intended to cover important areas of the securities industry which had not been covered by the earlier statutes. The Investment Companies Act is concerned with investment companies and other persons, including certain investment advisers, who deal with investment companies. The Advisers Act covers *all* investment advisers.

As stated in Section 201 of the Advisers Act, 15 U.S.C. § 80b-1 (1970), that Act was based upon the findings and recommendations set forth in an SEC Report on investment counsel and advisory services. Securities and Exchange Commission, Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services, H.R.Doc. No. 477, 76th Cong., 2d Sess., 1 (1939) (hereinafter "SEC Report"). The SEC Report referred to two types of investment advisers: (1) those with management powers over their clients' funds and the power to make purchases and sales for their clients ("discretionary"), and (2) those who merely made recommendations to their clients ("advisory"). SEC Report at 13. It noted the conspicuous need for regulation of individuals "who may solicit the funds of the public to be *controlled, managed,* and supervised . . . ." (emphasis added) SEC Report at 28. The report made it clear that its findings and recommendations were intended to cover persons who made purchases and sales of securities with their clients' funds.

The House and Senate Committee reports also make clear the intent of Congress. The Report of the Senate Committee on Banking and Currency which accompanied the bill to the Senate floor stated:

> "The report of the Commission to the Congress and the record before the committee is clear that the solution of the problems and abuses of investment advisory services—*individuals and companies which either handle pools of liquid funds of the public or give advice with respect to security transactions*—cannot be effected without Federal legislation.
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> • • •
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> Virtually no limitations or restrictions exist with respect to the honesty and integrity of persons who may solicit funds to be *controlled, managed,* and supervised." (emphasis added) S.Rep. No. 1775, 76th Cong., 3d Sess., 21 (1940).[14]

14. In its general statement on the background to the Advisers Act, the Senate Report stated:

> "Similarly, it is difficult definitely to estimate the amount of funds under the influence *or control* of investment advisers. However, some idea of the size of the funds administered by investment advisers may be deduced from the fact that 51 firms for which information was obtainable by the Commission *managed, supervised* and gave investment advice with respect to funds aggregating approximately $4,000,000,000." (emphasis added) S.Rep., *supra* at 21.

Similarly, the House Committee on Interstate and Foreign Commerce noted in its report the need to regulate firms which "managed, supervised, and gave investment advice" with respect to clients' funds. H.R.Rep. No. 2639, 76th Cong., 3d Sess., 27 (1940).[15]

[6] In short, as for legislative intent, we believe that the SEC Report, together with the House and Senate Reports, make it clear that Congress intended to reach persons who receive compensation for investing funds of their clients.

[7, 8] Moreover the plain language of Section 202(a)(11) and related provisions of the Act bear out this legislative intent. Section 202(a)(11) includes any person who "advises" others with respect to investments. Section 203(c)(1)(D), 15 U.S.C. § 80b-3(c)(1)(D) (1970), requires the investment adviser to disclose the nature and scope of his "authority . . . with respect to clients' funds and accounts" in his registration statement. And Section 205, 15 U.S.C. § 80b-5 (1970), establishes certain standards for investment advisers with respect to "investment advisory contracts" which include contracts "to act as an investment adviser or to manage any investment or trading account . . . ." These provisions reflect the fact that many investment advisers "advise" their customers by exercising control over what purchases and sales are made with their clients' funds.

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15. In 1960 and again in 1970, Congress considerably broadened the coverage of the Advisers Act. The Senate Report accompanying the bill which contained the 1960 amendments to the Act stated, with particular application here:

> "There are at present over 12½ million individuals in the United States who own corporate securities, nearly double those in 1952. It has been noted that this new group offers strong temptation to confidence men and swindlers who may give them biased advice *or misuse their funds or securities.*" (emphasis added) S.Rep. No. 1760, 86th Cong., 2d Sess. 4 (1960), reprinted in [1960], U.S. Code Cong. & Admin.News, at 3502.

We hold that the defendant general partners of FBA are investment advisers within the meaning of Section 202(a)(11) of the Act.[16]

(2) *Private Right of Action Under Section 206*

[9] As with other provisions of the federal securities laws under which the courts have found implied private rights of action, Section 206 of the Advisers Act does not

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16. Defendant Harry Goodkin & Company argues that, since it was not an "investment adviser" it cannot be held liable for aiding and abetting a fraud committed by those who were investment advisers. Goodkin points out that Section 206 applies only to an investment adviser and that Section 202(a)(11)(B) excludes from the definition of an investment adviser an accountant acting in the practice of his profession. We agree that the exemption excludes an accountant's usual activities from the scope of the Act and excludes the accountant from coverage under the registration provisions and many of the other regulatory provisions of the Act even if the accountant is employed by an investment adviser. But the exemption does not shield the accountant from liability under the antifraud provisions of the Act if the accountant aids and abets an investment adviser with *knowledge* that his conduct is assisting an investment adviser in defrauding a client. Cf. Section 209(e) of the Act, 15 U.S.C. § 80b-9(e) (1970), which authorizes the SEC to seek injunctive relief and, if necessary, to recommend criminal proceedings against those who "aid, abet [or] counsel" violations of the Act. In view of the limitation of Section 206 to investment advisers, however, we believe that before Goodkin can be held liable as an aider and abetter, there must be a showing that Goodkin: (a) knew of the investment adviser-client relationship; (b) had knowledge of the fraud; and (c) acted in concert with the investment adviser. Cf. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976).

Whether Goodkin is liable for aiding and abetting the investment advisers is one of the issues to be determined at trial pursuant to our remand.

As to whether FBA itself is a proper defendant with respect to the Advisers Act claim, for aught that appears in the record before us, we have serious doubts. The general partners as individuals, not FBA as an entity, were the investment advisers. If upon remand, and after a hearing, the district court finds no more than the record now discloses with respect to the liability of FBA itself under the Advisers Act claim, it should dismiss as against the firm.

expressly authorize private actions. We therefore must decide whether a private right of action is to be implied under that section. For the reasons below, we hold that it is.[17]

[10] The Supreme Court has recognized in a variety of contexts that private rights of action may be implied in favor of the intended beneficiaries of a statute where necessary to implement the statute's underlying purposes. *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971); *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964); *Tunstall v. Brotherhood of Locomotive Firemen and Enginemen*, 323 U.S. 210 (1944); *Texas & Pacific R.R. v. Rigsby*, 241 U.S. 33 (1916). Cf. *Bivens v. Six Unknown*

17. The SEC has submitted to Congress a number of proposed amendments to the Advisers Act. One would provide explicitly for private actions under the Advisers Act. See Investment Advisers Act Release No. 491, 8 SEC Docket 744 (December 15, 1975). In announcing its proposal, the SEC repeated its view that the existing language was sufficient to imply a private right of action. Its proposal was intended to put to rest those few decisions which had found no implied right of action.

In the two district court cases in this Circuit in which the issue has been considered, the court has held that an implied right of action exists under the Advisers Act. *Jones v. Equitable Life Assurance Society*, 409 F.Supp. 370 (S.D.N.Y. 1975); *Bolger v. Laventhol, Krekstein, Horwath & Horwath*, 381 F.Supp. 260 (S.D.N.Y. 1975). *Accord, Angelakis v. Churchill Management Corp.*, CCH Fed.Sec.L.Rep. ¶ 95,285 (N.D.Cal. 1975). *Contra, Gammage v. Roberts, Scott & Co.*, CCH Fed.Sec.L.Rep. ¶ 94,761 (S.D.Cal. 1974); *Greenspan v. Eugene Campos Del Toro*, 73-638-Civ. (S.D. Fla. May 17, 1974).

The commentators who have reviewed these decisions agree that a private right of action should be implied under the Advisers Act. Note, Private Causes of Action Under Section 206 of the Investment Advisers Act, 74 Mich.L.Rev. 308 (1975); Lybecker, *Advisers Act Developments*, 8 Review of Securities Regulations 927, 934 (April 23, 1975); Note, Bolger v. Laventhol, Krekstein, Horwath & Horwath: Private Rights of Action Under the Investment Advisers Act, 48 Temple L.Q. 433 (1975).

Named Agents, 403 U.S. 388 (1971); *Bell v. Hood*, 327 U.S. 678 (1946).

There are compelling reasons why the courts have been particularly willing to recognize private rights of action under the antifraud provisions of the federal securities laws. Those provisions are designed to protect specific classes of injured parties. Moreover the SEC—the agency charged with administration and enforcement of the federal securities laws—does not have sufficient resources alone to enforce the many provisions of the statutes. Absent judicial recognition of private rights of action, the federal securities laws most assuredly would fail to provide the effective regulation over the securities industry which Congress intended. In finding an implied right of action under Section 14(a) of the 1934 Act, the Supreme Court held in *J. I. Case Co. v. Borak, supra*, 377 U.S. at 432, that "Private enforcement . . . provides a necessary supplement to Commission action", and went on to state:

"[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *Id.* at 433.

[11] Applying these principles, the courts of appeals consistently have recognized an implied right of action under the Investment Companies Act—the companion to the Advisers Act. *Moses v. Burgin*, 445 F.2d 369 (1 Cir.), *cert. denied*, 404 U.S. 994 (1971); *Herpich v. Wallace*, 430 F.2d 792, 815 (5 Cir. 1970); *Esplin v. Hirschi*, 402 F.2d 94, 103 (10 Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); *Taussig v. Wellington Fund, Inc.*, 313 F.2d 472, 476 (3 Cir.), *cert. denied*, 374 U.S. 806 (1963); *Brown v. Bullock*, 194 F.Supp. 207 (S.D.N.Y.), *aff'd*, 294 F.2d 415, 420-21 (2 Cir. 1961) (en banc). It is well settled that implied rights of action exist under Section 10(b) of the 1934 Act and Rule

10b-5, which contain substantially the same language as Section 206 of the Advisers Act. *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 730 (1975); *Superintendent of Insurance v. Bankers Life & Casualty Co., supra,* 404 U.S. at 13 n.9; *Fischman v. Raytheon Mfg. Co.,* 188 F.2d 783, 787 (2 Cir. 1951); *Kardon v. National Gypsum Co.,* 69 F.Supp. 512 (E.D.Pa.1946). Judicially implied rights of action also have been found under Section 14(a) of the 1934 Act, *J. I. Case Co. v. Borak, supra,* and under the Public Utility Holding Company Act of 1935, *Goldstein v. Groesbeck,* 142 F.2d 422 (2 Cir.), *cert. denied,* 323 U.S. 737 (1944).

Against this background, we turn to the question whether a private right of action should be implied under Section 206 of the Advisers Act.

In *Cort v. Ash,* 422 U.S. 66, 78 (1975), the Supreme Court suggested that the following factors be considered in determining "whether a private remedy is implicit in a statute not expressly providing one":

> "First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted' . . . —that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?" (emphasis in original)

We believe that each of these factors point unmistakably toward recognition of an implied right of action under

Section 206 of the Advisers Act. See *Piper v. Chris Craft Industries, Inc.,* 430 U.S. 1, 37-45 (1977).

[12] The purpose of the Advisers Act was "to protect the public and investors against malpractice by persons paid for advising others about securities."[18] The Act was designed for the "especial" benefit of persons relying upon their investment advisers for advice. *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 186-91 (1963).

Congress enacted the Advisers Act, as it had earlier securities legislation, mindful of the need for *federal* regulation of the securities industry. As the Senate Committee Report emphasized:

> "The nature of the functions of investment advisers, their increasing widespread activities, their potential influence on security markets and the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors, convinces the committee that protection of investors requires the regulation of investment advisers on a national scale.
>
> The report of the Commission to the Congress and the record before the committee is clear that *the solution of the problems and abuses of investment advisory services . . . cannot be effected without Federal legislation.*" (emphasis added) S.Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).

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18. S.Rep. No. 1760, 86th Cong., 2d Sess., 1 (1960).
The House Committee Report which accompanied the 1940 bill stated:

> "The essential purpose of title II of the bill is to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful." H.R.Rep. No. 2639, 76th Cong., 3d Sess., at 28 (1940).

We are not aware of any statement indicating that Congress considered the problem of private actions under the Advisers Act at the time of its enactment. Nor is there any indication that the SEC considered this matter when it adopted Rule 206(4)-1. Absent specific statements of legislative intent, we must examine the legislative purposes underlying the Act.

As stated above, the courts consistently have recognized that the Commission's resources are inadequate to the task of policing alone the federal securities laws. In enacting the 1940 legislation, Congress intended to provide effective *federal* regulation of an important segment of the securities industry. Failure to recognize a private right of action under the Advisers Act would effectively frustrate that purpose. We hesitate to reach such a result absent clear evidence from the Act's legislative history that private actions were not intended.

Turning to related provisions of the Advisers Act, Section 215(b), 15 U.S.C. § 80b-15(b) (1970), provides that any contract in violation of the Act shall be void. As the courts have held in construing nearly identical provisions of the other securities acts, the language of Section 215(b) strongly suggests that a private remedy should be implied and that such a remedy would be consistent with the other provisions of the Act. *Fischman v. Raytheon Mfg. Co., supra,* 188 F.2d at 787 n.4; *Kardon v. National Gypsum, Co., supra,* 69 F.Supp. at 514; see *Slavin v. Germantown Fire Ins. Co.,* 174 F.2d 799, 815 (3 Cir. 1949).

[13] In arguing that a private right of action should not be recognized under the Advisers Act, appellees point to the difference between the language found in the jurisdictional provision of the Advisers Act and similar provisions of

other securities acts.[19] Section 214 of the Advisers Act, 15 U.S.C. § 80b-14 (1970) in relevant part provides:

> "The district courts of the United States . . . shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations or orders thereunder."

By contrast, Section 22 of the 1933 Act, 15 U.S.C. § 77v (1970), Section 27 of the 1934 Act, 15 U.S.C. § 78aa (1970), and Section 44 of the Investment Companies Act, 15 U.S.C. § 80-a-43 (1970), provide that the district courts shall have jurisdiction of "all suits in equity *and actions at law* brought to enforce any liability or duty created by" those Acts.

Appellees argue that the omission of any reference to "actions at law" in Section 214 manifests a legislative intent to preclude private rights of action under the Advisers

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19. Appellees also argue that recognition of a private right of action would be inconsistent with Section 209(e) of the Act and other enforcement provisions which provide that the Commission "may in its discretion bring an action" for injunctive relief. We find no merit in this argument. *The enforcement powers given the Commission under the Advisers Act are virtually identical to those of the other securities acts under which we have recognized implied private rights of action.* Unlike the Securities Investor Protection Act, which was involved in *Securities Investor Protection Corp. v. Barbour,* 421 U.S. 412 (1975), the Advisers Act in general, and the antifraud provisions in particular, do not manifest a specific legislative intent to restrict enforcement to the Commission. Here, private suits would be consistent with Commission action. The provision allowing the Commission the usual discretion to sue simply makes it clear that the SEC is not *compelled* to sue in *every* case. Indeed it would be extraordinary for Congress to require an agency to bring enforcement proceedings in every instance. The Court in *Barbour* distinuished *J. I. Case Co. v. Borak,* where the Court had found private suits a necessary supplement for—rather than a hindrance to—Commission action. 421 U.S. at 423.

Act. We disagree. In our view, the reason for this omission is that each of the other Acts whose jurisdictional provisions refer to "actions at law" contains one or more sections *expressly* granting injured parties a private right of action for damages.[20] There is no provision in the Advisers Act which *expressly* provides for private actions; since it is a less complex statute, containing no express grants of right of action to private parties, a reference to "actions at law" would be superfluous.

There is not a shred of evidence in the legislative history of the Advisers Act to support the assertion that Congress intentionally omitted the reference to "actions at law" in order to preclude private actions by investors. Section 214, like the jurisdictional provisions of the other securities acts, was drawn to provide jurisdiction over actions expressly authorized by the statute. Far from indicating that Congress ever considered the matter of private actions in drafting Section 214, the only legislative history indicates that Congress attached no great importance to its omission. In their only references to Section 214, both the Senate and House Reports stated that the enforcement provisions of the Advisers Act were "generally comparable" to those of the Investment Companies Act whose jurisdictional provision contains the "actions at law" language. S.Rep. No. 1775, 76th Cong., 3d Sess., at 23

20. See Sections 11 and 12 of the 1933 Act, 15 U.S.C. §§ 77k and 77l (1970); Sections 9(e), 16(b) and 18 of the 1934 Act, 15 U.S.C. §§ 78i(e), 78p(b) and 78r (1970); Sections 16(a) and 17(b) of the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79p(a) and 79q(b) (1970); Section 323(a) of the Trust Indenture Act of 1939, 15 U.S.C. § 77www(a) (1970); and Section 30(f) of the Investment Companies Act of 1940, 15 U.S.C. § 80a-29(f) (1970).

(1940); H.R.Rep. No. 2639, 76th Cong., 3d Sess., at 30 (1940).[21]

In dealing with private rights of action under other securities acts, courts have referred to the "actions at law" language under the jurisdictional provisions to indicate the overall structure of those acts. But the "actions at law" language has never been relied upon as evidence that Congress *explicitly* considered the matter of private damage actions under the particular substantive provision in question. Had Congress provided explicitly for private damage actions it would be unnecessary to consider whether the remedy should be judicially implied. Indeed, under the anti-fraud provisions of other securities acts courts have recognized the *absence* of any legislative intent either to create or to deny private rights of action for damages. Here, as under the other statutes, it is clear that Congress simply did not consider the matter.[22]

21. As originally introduced in the House and Senate, the proposed Advisers Act merely incorporated the jurisdictional provision of the Investment Companies Act. Section 203 of S. 3580 and H.R. 8935. The Investment Companies Act, in turn, had adopted the same language as found in Section 25 of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79y. Section 40(a)(1) of S. 3580 and H.R. 8935. As reported out of the committees, the bills omitted all references to other statutes; and the Advisers Act was given its own jurisdictional provision which did not contain any reference to "actions at law brought to enforce any liability . . . ."

22. We need not decide whether the language of Section 214 which grants to the district courts jurisdiction over "violations of this subchapter or the rules, regulations, or orders thereunder" might cover private damage actions. See *Bolger v. Laventhol, Krekstein, Horwath & Horwath, supra,* 381 F.Supp. at 264. Courts have implied private rights of action under statutes which have no separate jurisdictional provision for civil damage suits. *Texas & Pacific R.R. Co. v. Rigsby, supra,* 214 U.S. at 39; *Odell v. Humble Oil & Refining Co.,* 201 F.2d 123, 126 (10 Cir. 1953); *Narramore v. Cleveland, C.C. & St.L. Ry. Co.,* 96 F. 298, 300 (6 Cir. 1899). Moreover, the general federal question jurisdictional provision, 28 U.S.C. § 1331 (1970), would apply here. See *Brown v. Bullock, supra,* 294 F.2d at 418.

The Supreme Court, in considering a different issue under the Advisers Act in *SEC v. Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 195, emphasized that the Act should "be construed like other securities legislation 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but flexibly to effectuate its remedial purposes." (footnote omitted). We find that particularly cogent here where we are asked to determine whether there should be a private right of action to recover damages for what may be clear violations of the Act. Moreover, mindful of the Supreme Court's admonition in *J. I. Case Co. v. Borak, supra,* 377 U.S. at 433, we believe that we should provide "such remedies as are necessary to make effective the congressional purpose", rather than adopt a construction that would effectively defeat the purpose of providing federal regulation over an important segment of the securities industry.

We hold that there is an implied private right of action under Section 206 of the Advisers Act.[23]

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23. Our concurring-dissenting colleague, in a characteristically thoughtful and innovative opinion, urges that a private right of action for damages should not be implied under the Advisers Act. We suggest that Judge Gurfein's opinion be read in the light of the following observations.

First, the basic premise of the dissent is the assumption that the Advisers Act was intended to provide "a *compulsory census* of investment advisers, and not . . . a pervasive regulatory scheme." (emphasis added) Post, 879, 883. A careful reading of the Advisers Act shows that, as enacted, it requires far more than a census. As the last of the series of federal securities laws enacted between 1933 and 1940, it is an integral part of a comprehensive regulatory scheme intended by Congress to eliminate certain abuses in the securities industry. The Supreme Court in *SEC v. Capital Gains Research Bureau, Inc., supra,* in referring to a fundamental purpose of the Advisers Act and its relationship to the other federal securities regulatory acts, stated:

> "The Investment Advisers Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. It was preceded by the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act of 1940. A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, 'It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail' in every facet of the securities industry. *Silver v. New York Stock Exchange,* 373 U.S. 341, 366." (footnotes omitted) 375 U.S. at 186-87.

Second, while we do not claim the expertise of our dissenting colleague concerning hedge funds, post, 879, & n. 1, 884, we do suggest that much of the speculation of the dissent with respect to the investment policy of the general partners as managers of the fund (e. g. whether the partnership "was going to operate in the most speculative of investment activities", post, 884) and the intentions of plaintiffs in becoming limited partners, might better await the trial on the merits to which we have held plaintiffs are entitled. For after all, the posture of the case as it came to us from the district court was the dismissal of the complaint on the ground that plaintiffs realized a net profit on their overall limited partnership investments and therefore failed to prove damages compensable under the federal securities laws. 392 F.Supp. 740. While this holding of the district court is rejected, all we hold with respect to plaintiffs' Advisers Act claim is that they are entitled to their day in court

(3) *Compensable Damages Under the Advisers Act*

[14] Appellees contend that plaintiffs have not alleged compensable damages under the Advisers Act. They argue that plaintiffs themselves were neither purchasers nor sellers of securities and that their claims are speculative because they are based upon the assertion that plaintiffs would have withdrawn from FBA earlier had they been told the truth about the partnership's investments. We disagree.

At the outset, we find no basis for appellees' assumption that plaintiffs' only alternative, had they learned the truth

earlier about FBA's high percentage of investments in unregistered securities, was to withdraw their funds. Plaintiffs might have tried to persuade the general partners to conform the firm's investments to the conservative policy they had represented. Failing that, plaintiffs might have mobilized the other limited partners to exert pressure on the general partners.

We find appellees' reliance upon *Blue Chip Stamps v. Manor Drug Stores, supra,* on this aspect of the instant case to be misplaced.

[15] The *Blue Chip* decision was based on the *express language* of Section 10(b) and Rule 10b-5 requiring a fraud

and an opportunity to prove their claim. Post, 879. At that time, when the credibility of witnesses can properly be determined, many of the speculative factual issues suggested by the dissent appropriately can be resolved.

Finally, and perhaps of chief significance, the dissent does not dispute the eloquent absence of evidence that Congress ever considered allowing damages, as distinguished from injunctive relief, under the Advisers Act. The question of damages was not considered because the matter of a private right of action was not considered. The dissent's massive reliance upon the omission of the "actions at law" language in the Advisers Act and its inclusion in the jurisdictional provisions of other statutes, we think is misplaced. Judicially implied private rights of action have been recognized under various sections of the securities laws even though those sections, unlike other sections of the same statutes, contain no explicit provision for private actions. Here likewise there is no evidence that the omission was meant to exclude private actions. In this respect the present case is plainly different in a significant legal respect from *National R. R. Passenger Corp. v. National Ass'n of R. R. Passengers*, 414 U.S. 453 (1974), relied upon by the dissent, where "the legislative history of the Amtrack Act provide[d] a clear and convincing expression of Congress' intent to preclude anyone except the Attorney General and in certain situations an employee or his duly authorized representative from maintaining an action under the Act against petitioners" (414 U.S. at 465 (Justice Brennan concurring)), and transportation policies not pertinent here militated in favor of such a limitation. No such history or policies are to be found here.

"in connection with the purchase or sale of any security."[24] *Neither Section 206 of the Advisers Act nor Rule 206(4)-1 contains any such requirement.* While the Court stated in *Blue Chip* that the purchaser-seller limitation under Section 10(b) protected against vexatious and speculative claims, it did not say or suggest that *any* claim would be too speculative for recovery under the other securities acts unless the plaintiff was a purchaser or seller. Indeed the Court acknowledged that provisions of the other securities acts afford rights of action to persons who are not purchasers or sellers. 421 U.S. at 733-34.

[16] Acceptance of appellees' contention, moreover, would lead to a construction of the Advisers Act clearly inconsistent with the intent of Congress. As indicated above, Congress intended to protect investors against frauds committed by investment advisers who managed their clients' funds, as well as frauds committed by advisers who did not make purchases and sales for their clients. If the claims of a client whose adviser managed his funds were to be held to be too speculative simply because the client failed to allege that he would have taken some remedial action if he had known the truth, a large segment of those investors whom Congress meant to protect would be excluded from the Act's coverage. To accept appellees'

24. The holding in *Blue Chip* was that persons who claimed that they had been fraudulently induced *not* to purchase securities were not within the class of persons protected by Section 10(b) of the 1934 Act and Rule 10b-5, under which recovery is limited to funds "in connection with the purchase or sale" of securities. In reaffirming the doctrine of *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2 Cir.), *cert denied*, 343 U.S. 956 (1952), the Court also stated that "actual shareholders in the issuer who allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material" might not be able to sue under Section 10(b) and Rule 10b-5. *Blue Chip Stamps v. Manor Drug Stores, supra*, 421 U.S. at 737-38.

contention would lead to the incongruous result that an investor's claims would be speculative even if the adviser had made fraudulent statements to conceal the fact that he was stealing his client's funds.

[17] We believe that the differences in the language and purposes of Section 10(b) of the 1934 Act and Section 206 of the Advisers Act distinguish the instant case from *Blue Chip*. We also note that the policy considerations expressed in *Blue Chip* lend no support to appellees' arguments.[25] Under Section 206, the plaintiff class is limited to the investment adviser's own clients. Since the investment adviser is compensated for his services, both client and adviser understand that the client will rely upon the adviser's judgment and advice. To characterize the client's reliance as speculative is to ignore the essence of the relationship. See *Galfand v. Chestnutt Corp.*, 545 F.2d 807 (2 Cir. 1976). Plaintiffs here allege fraudulent representations relating to specific purchases and sales of unregistered securities, thus providing a definable measure of damages. And a defrauded client may be deprived of *numerous* means of controlling his adviser's conduct and the management of his investments, only one of which is the remedy of withdrawing his funds altogether. We believe

25. In interpreting the express language of Section 10(b) and Rule 10b-5 in *Blue Chip*, the Court expressed concern about suits by persons who neither purchased nor sold securities but who claimed that they would have purchased or sold securities but for false representations made by someone whom they might not even have known. The Court noted that the "purchase or sale" requirement protected against vexatious suits by a potentially limitless class of plaintiffs and avoided the difficult questions of determining whether a plaintiff would or would not have purchased or sold securities but for the defendant's representations. *Id.* at 745-47.

Far from holding that claims of persons who were neither purchasers nor sellers would be too speculative under the other securities acts, the Court interpreted the express language of Section 10(b) and Rule 10b-5. And the Court expressly noted that many of the other securities acts have no "purchase or sale" requirement. 421 U.S. at 733-34.

that the limited uncertainties involved in a case such as this are not sufficient to bar recovery on an otherwise valid claim; and they are adequately offset by requiring proof that the misrepresentations were material and proof of reliance.[26]

[18, 19] We hold that plaintiffs have alleged damages compensable under Section 206 of the Advisers Act.[27]

IV. MEASURE OF DAMAGES ON REMAND

In view of our remand for trial on the Advisers Act claim, we believe that the district court is entitled to some guidance on the proper measure of damages.

26. Even the claims of a person who has purchased or sold securities are not free of uncertainties. A purchaser or seller necessarily alleges that he would *not* have made the purchase or sale had he known the true facts.

Although the claims of persons who neither purchased nor sold securities, in individual cases, may be *less* speculative than the claims of actual purchasers or sellers, *Blue Chip* weeds out suits by persons who may have had no interest in a security until discovering that someone has made a fraudulent statement which may give rise to a lawsuit. In view of the settlement value of a securities suit, this is an important consideration. Obviously an investor who has paid for the advice of his adviser is not the type of disinterested bystander at whom the *Blue Chip* decision was primarily aimed.

27. It is important to note that there is no issue in this case as to whether an investor may recover for negligent misrepresentations by his investment adviser. See *Ernst & Ernst v. Hochfelder, supra; Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1298-1301 (2 Cir. 1973) (distinguished in *Ernst & Ernst v. Hochfelder, supra*, 425 U.S. at 209 n. 28); *SEC v. Capital Gains Research Bureau, Inc., supra*. Plaintiffs here have alleged that defendants' misrepresentations were *intentional*. Whether defendants thought that the price of the unregistered securities would rise or not has no bearing on the issue of scienter. Although the general partners' own funds were part of FBA's pooled assets, they would be liable under Section 206 if they *intentionally* deceived the limited partners to prevent the limited partners from withdrawing their contributions *or for any other reason. Ernst & Ernst v. Hochfelder, supra.* Scienter does not require a showing of intent to cause a loss to a plaintiff. *SEC v. Capital Gains Research Bureau, Inc., supra*, 375 U.S. at 192 n. 39.

We do not agree with the district court's holding, 392 F.Supp. 740, that, since plaintiffs realized a net profit on their overall limited partnership investment, they failed to prove damages compensable under the federal securities laws.

[20] This is not to say, however, that a plaintiff may recover for losses, but ignore his profits, where both result from a *single* wrong. In determining on remand whether plaintiffs have sustained any damages from the alleged fraudulent investments, the district court should determine, first, at what point defendants' representations became fraudulent due to the increasing proportion of portfolio investments in unregistered securities. The court then should compute the total net losses on all holdings of unregistered securities due to changes in price *after* that date. Finally, the court should determine what proportion of FBA's holdings was inconsistent with representations that the partnership was in a "most conservative posture" and the other representations made to the limited partners. The proper measure of damages then would be that part of net losses incurred on unregistered securities after the point when the defendants' representations became fraudulent which stems from the portion of those investments inconsistent with defendants' representations.[28]

We of course do not intimate any views as to whether plaintiffs in fact have sustained *any* damage and, if so, *how much*. All we hold is that they are entitled to their day in court and an opportunity to prove, if they can, their claim under the Advisers Act.

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28. The cut-off price for such unregistered securities in the portfolio at the time plaintiffs withdrew should be the value assigned to such securities by the general partners, since that presumably is what plaintiffs received. This would provide the closing out price for loss-netting purposes with respect to securities remaining in the portfolio at the time of plaintiffs' wihdrawal.

Affirmed as to the dismissal of the Securities Exchange Act claim; as to the dismissal of the Investment Advisers Act claim, reversed and remanded for trial.

GURFEIN, Circuit Judge, concurring and dissenting:

I concur in the affirmance of the dismissal of the § 10(b) claim.

With great respect for my brother Timbers as a master of securities law, I must respectfully dissent from the holding that, under this complaint, we should imply a private right of action at law for damages for alleged violation of § 206 of the Investment Advisers Act, 15 U.S.C. § 80b—6 ("Advisers Act") by these limited partners of a speculative hedge fund.[1]

According to the majority, the issue in this case is whether to imply a *private* right of action. It therefore draws an analogy to other securities act provisions under

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1. The Hedge Fund partnership agreement gave the general partners the following powers:

> "(a) To purchase, hold and sell stocks, bonds and other securities; (b) to sell stocks, bonds and other securities short and to cover such sales; (c) to purchase, hold, sell and otherwise deal in put and call options and any combination or combinations thereof; (d) to purchase, hold, sell, sell short and cover, and borrow from brokers for that purpose, commodity contracts and to purchase, hold, sell and otherwise deal in commodities generally dealt in on commodity or produce exchanges, provided, however, that Partnership funds used for the purpose of dealing in commodities and commodity contracts shall not exceed at the time of any purchase or commitment ten (10) percent of the net worth of the Parnership at July 1, 1965 or at the beginning of any calendar year thereafter, as the case may be; (e) to conduct margin accounts with brokers; (f) to open, maintain and close bank accounts; (g) to sign checks; (h) to pledge securities for loans; (i) to engage in the business of advising and counseling on investments and to enter into agreements therefor, and (j) generally, to act for the Partnership in all matters incidental to the foregoing."

The original partnership agreement was amended twice, but the amendments did not affect the management's broad discretionary powers.

which private rights of action have been implied. It seems to me, however, that the issue is rather whether a private action at law for *damages* should be implied. With reference to that issue, I think that the Investment Advisers Act differs significantly from the securities statutes upon which the majority draws for support.

The legislative history of the Advisers Act indicates that it was a tentative attempt to effect a "compulsory census" of investment advisers by requiring registration rather than to provide a full regulatory scheme. David Schenker, representing the SEC, testified in the Senate Hearings:

> Therefore, our fundamental approach to this problem is in the first instance, before we could intelligently make an appraisal of the economic function or of the abuses which might exist in that type of organization, to see if we could not get something which approximated *a compulsory census. Fundamentally that is the basic approach of title 2.* [The Advisers Act]. We first would like to find out how many people are engaged in this business, what their connections are, what is the extent of their authority, what is their background, who they are, and how they handle the people's funds" (emphasis added).

Hearings on S. 3580 before the Subcomm. of the Senate Comm. on Banking & Currency, 76 Cong., 3d Session 48. *See also* S.Rep. No. 1760, 86th Cong., 2d Sess., U.S.Code Cong. & Adm.News 1960, p. 3502. There are other indications that "as enacted, the Investment Advisers Act represented a compromise between the SEC and the investment advisory industry." *See Note, Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich.L. Rev. 308, 319-30 & n.69 (1975).[2] It is in light of

2. See p. 880 & n. 3 infra.

this cautious approach taken by Congress in enacting the Advisers Act as tentative legislation that Section 214, the provision which appears to allow only suits in equity, should be read.

Section 214 is unlike the corresponding sections in the other Acts. As my Brother Timbers notes, the Advisers Act gives the district courts jurisdiction, concurrently with state courts, only "of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder." The other Acts, by contrast, provide jurisdiction not merely over "all suits in equity," but also over "actions at law brought to enforce any liability or duty created thereby, or to enjoin any violation of this subchapter, or the rules, regulations or orders thereunder," *e.g.,* Investment Company Act of 1940, § 44, 15 U.S.C. § 80a—43, an act passed together with the Advisers Act in a single bill.[3] For similar language in other Acts, *see* majority opinion p. 874, n.20.[4]

3. It seems to me of some significance that early drafts of the Advisers Act, including S. 3580 and H.R. 8935, filed on March 14, 1940, merely incorporated by reference § 40 of the Investment Companies Act, which did include the reference to "actions at law." After the conclusion of four weeks of Senate hearings on April 26, however, representatives of the industry met with the SEC to negotiate changes in the proposed bill. *See Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce,* 76th Cong., 3d Sess. 72 (1940); 86 Cong.Rec. 10069 (1940) (remarks of Senator Wagner). The result was a new draft, which finally met the approval of the industry, *see House Hearings* at 95; Jaretski, *The Investment Company Act of 1940,* 26 Wash.L. Rev. 303, 309-10 (1941), and which for the first time contained a separate jurisdictional provision referring to "suits in equity" but omitting the reference to "actions at law" which the majority seeks to restore to the statute.

4. While the majority opinion does not rely on the circumstance that jurisdiction is conferred over "violations" of the statute and rules thereunder to imply a cause of action for damages at law, a district court has done so. *See Bolger v. Laventhol, Krekstein, Hor-*

The attempted withholding of jurisdiction over actions at law in the Advisers Act indicates that Congress was not intending to provide for *any* liability beyond injunctive relief.[5] As Mr. Justice Powell noted in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756, 95 S.Ct. 1917, 1935, 44 L.Ed.2d 539 (concurring), "[t]he starting point in every case involving construction of a statute is the language itself." The majority opinion explains that the language of § 214 differs from the language of the jurisdictional sections in every other Securities Act because "each of the other Acts whose jurisdictional provisions refer to 'actions at law' contains one or more sections *expressly* granting injured parties a private right of action for damages,'"

wath & Horwath, 381 F.Supp. 260 (S.D.N.Y. 1974). I do not agree. "Violations" in the context means criminal violations, and violations on the civil side are limited to suits in equity. This is made clear by the venue provisions of § 214: (1) "any criminal proceeding" may be brought in the district court wherein any act or transaction constituting the violation occurred; (2) "any suit or action to enjoin any violation . . . may be brought in . . . ." There is still no reference to an "action at law."

5. One might indeed argue that there is lack of subject-matter *jurisdiction* to enforce actions at law for damages for violations of the Advisers Act because of the lack of any specific statutory authorization, but I do not urge that. There is jurisdiction under a broad reading of the "arising under" clause of 28 U.S.C. § 1331. *Cf. Illinois v. City of Milwaukee*, 406 U.S. 91, 98, 92 S.Ct. 1385, 31 L.Ed.2d 712 (1972); *Romero v. International Terminal Operating Co.*, 358 U.S. 354, 393, 79 S.Ct. 468, 3 L.Ed.2d 368 (1959) (Brennan, *J.*, concurring and dissenting); *Bell v. Hood*, 327 U.S. 678, 66 S.Ct. 773, 90 L.Ed. 939 (1946). *See also Tunstall v. Brotherhood of Firemen*, 323 U.S. 210, 65 S.Ct. 235, 89 L.Ed. 187 (1944) ("arising under" 28 U.S.C. § 1337). The majority correctly states that plaintiffs allege jurisdiction under § 214 of the Advisers Act, the very section that does *not* provide for "actions at law," but since the pleading can be amended I make no point of the insufficiency of a proper jurisdictional statement. Even if an implied claim for relief is judge-made, it may "arise under the laws of the United States."

and hence, required the jurisdictional provision for that reason.[6]

6. The reason given by the majority is not persuasive, for it fails to note that in every single case in which an express civil liability is created in *any* of the Acts, the jurisdiction has *already* been stated in the very section creating the express liability. Thus, § 11 of the 1933 Act, 15 U.S.C. § 77k, *itself* provides that "any person acquiring such security . . . may, either at law or in equity, in any court of competent jurisdiction, sue . . .." Section 12 of the 1933 Act, 15 U.S.C. § 77l, *itself* provides that the purchaser "may sue either at law or in equity in any court of competent jurisdiction . . .." To the same effect, *see* Section 9(e) of the 1934 Act, 15 U.S.C. § 78i(e); Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b); Section 18 of the 1934 Act, 15 U.S.C. § 78r; Section 16(b) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79p(b); Section 17(b) of that Act, 15 U.S.C. § 79q(b); Section 323(a) of the Trust Indentures Act, 15 U.S.C. § 77www(a); Section 30(f) of the Investment Companies Act, 15 U.S.C. § 80a-29(f). The better explanation, it seems to me, for the general jurisdictional provision in each Act—"the District Courts of the United States . . . shall have jurisdiction" etc.—is Congress' fear that general federal question jurisdiction under 28 U.S.C. § 1331 might not establish jurisdiction in the *federal* courts over securities law claims, particularly when the jurisdictional amount was lacking. The separate jurisdictional provisions associated with the several sections of the securities acts creating substantive liability referred only to "any court of competent jurisdiction," and hence left open the question of whether the federal courts were in fact courts of "competent jurisdiction." Thus, an independent jurisdiction was conferred on the federal courts by the general provision of each statute (and in the case of the Securities Exchange Act, exclusive jurisdiction). In short, the internal sections conferred general jurisdiction. The jurisdictional section was drawn as broadly as possible to confer clear *federal* jurisdiction.

The majority opinion seeks to draw support from the fact that the Senate and House Reports stated that the enforcement provisions of the Advisers Act were "generally comparable" to those of the Investment Companies Act. *Ante* at 875. Aside from the fact that this begs the crucial question—whether the Acts were comparable in this particular respect—it ignores what was in my view the more likely meaning of "generally comparable" as applied to the enforcement provisions: that is, that the Advisers Act is "generally comparable" to the Investment Company Act in that both provide for the concurrent jurisdiction of state and federal courts, as distinguished from the Exchange Act in which federal jurisdiction is made exclusive.

But the more cogent question is why the Advisers Act, as distinguished from every other securities act, does not provide for *any express* civil liability in damages. The majority offers no explanation for such an omission which must have been a studied omission. I think it is highly relevant that in *each* of the other Acts Congress itself did provide for some *express* civil liability, yet under the Advisers Act it failed to include a single section imposing liability for damages. Congress, for example, could have provided an express damage remedy for misrepresentations in the registration statement of the advisers as it did for misrepresentations of the registration statement of the underwriter, 15 U.S.C. § 77k(a)(5). This indicates rather that, in its cautious approach to the regulation of investment advisers, Congress was not yet ready to impose *any* civil liability for damages.

The majority holds, nonetheless, that a private damage action should be implied in this case "to implement the statute's underlying purposes." It notes that persons relying upon investment advisers for advice, for whose "especial benefit" the Act was adopted, *see Cort v. Ash,* 422 U.S. 66, 78, 95 S.Ct. 2080, 45 L.Ed.2d 416 (1975), will benefit from a private damage action. *Ante,* pp. 872-873 *citing SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 186-91, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963).[7] Such reasoning it seems to me has become somewhat outmoded in the light of the current standards of interpretation announced in *Cort v. Ash, supra.* The *four* factors mentioned in *Cort v. Ash* are not mere surplusage to the theme that the beneficent purpose of the legislation is, by itself, sufficient warrant for

7. That case was not, of course, a damage action, nor was it brought by a private party.

the implication of a claim for private relief.[8] Such a single criterion is also inadequate because a statute can have more than one "beneficent purpose"—here, to protect investors but also to avoid undue disruption of the investment advisory industry. To put it another way, Congress may intend a statute to protect investors—but not necessarily without limit. Countervailing considerations may result in something less than an imposition of civil liability for money damages. The majority opinion ignores this problem of statutory construction, in my view, because it gives insufficient weight to the second factor listed in *Cort:* "is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one?"[9] As shown

8. The majority reasons that Section 215(b) of the Advisers Act, 15 U.S.C. § 80b-15(b) (1970), which provides that any contract violating the Act shall be void, strongly suggests that a private remedy should be implied. *Ante,* p. 874, *supra.* But it does violence to the criteria enunciated in *Cort* to imply an action simply because a contract is made void, or to recognize an actionable tort, simply because a statute prohibits particular conduct. *Cf.* Note, *Section 206 Private Actions,* 74 Mich.L.Rev. 308, 312 n.19 (1975). Significantly, the SEC in its *amicus* brief does not rely on § 215(b) of the Act.

Even if the fact that a statute renders certain contracts void were deemed *ipso facto* to create a private right of action, on the theory that this provision could be vindicated only by the private parties to the contract, it of course by no means follows that a *damage* remedy is proper. Rescission or restitution are, aside from damages, remedies ordinarily available when a contract is void. Significantly, rescission is an equitable remedy. *see* 5 Corbin on Contracts § 1103, so that implication of a private right of action for rescission and restitution under § 215(b) would be well within the jurisdictional grant of § 214, and consistent with the notion that it is only *actions at law* which are inconsisent with the statutory scheme.

9. Analytically, it would be equally proper to say that implication of a private action under the Advisers Act is not "consistent with the underlying purposes of the legislative scheme." *Cort, supra,* 422 U.S. at 78, 95 S.Ct. at 2088. For though such a remedy may be consistent with the goal of protecting customers of investment advisers, it is hardly consistent with the desire not to subject advisers to monetary liability, at least, until further study by Congress.

above, there *is* implicit legislative intent to deny such a remedy.[10]

The majority urges that there is no evidence that Congress intentionally sought to preclude private damage actions. *Ante,* p. 874. But there is surely no "clear evidence" that Congress affirmatively intended private actions for damages to lie for violation of § 206. And we have been instructed recently in *National Railroad Passenger Corp. v. National Ass'n of Railroad Passengers,* 414 U.S. 453, 458, 94 S.Ct. 690, 693, 38 L.Ed.2d 646 (1974) (*"Amtrak"*) that "'when a statute limits a thing to be done in a particular mode, it includes the negative of any other mode,'" *quoting Botany Mills v. United States,* 278 U.S. 282, 289, 49 S.Ct. 129, 72 L.Ed. 730 (1929). Section 214 expressly confers jurisdiction over suits in equity only, and the Act as a whole does not provide anywhere for actions at law. Under the *Amtrak* formulation, when Congress limits relief to equitable relief, "it includes the negative of any other mode"—monetary liability. In *Amtrak* Mr. Justice Stewart observed that, in determining whether a private action would lie, this rule of statutory construction should yield only "to clear contrary evidence of legislative intent," 414 U.S. at 458, 94 S.Ct. at 693, a situation that does not exist in the case of the Advisers Act.

Similarly, in *Securities Investor Protection Corp. v. Barbour ("SIPC"),* 421 U.S. 412, 95 S.Ct. 1733, 44 L.Ed.2d 263 (1975), Mr. Justice Marshall noted that where there is express statutory provision for one form of proceeding, this "ordinarily implies that no other means of enforcement was intended by the Legislature," 421 U.S. at 419, 95 S.Ct. at 1738, again emphasizing that the implication would yield only to "clear contrary evidence of legislative intent." I think that my brothers turn this test backwards. And as we have seen, there are strong reasons for believing that not only is there no "clear contrary evidence of legislative intent" but rather that whatever evidence exists looks the other way.

That a statute explicitly provides for private rights of actions in some sections does not, of course, preclude the implication of other actions under different sections of the same Act. *J. I. Case Co. v. Borak,* 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964); *see* 6 L. Loss, *Securities Regulation,* 3869-73 (Supp. 1969). *Cf.* 1 A. Bromberg, *Securities Law: Fraud* § 2.4(1) (1975); *Note, Private Rights of Action Under* Amtrak *and* Ash: *Some Implications for Implication,* 123 U.Pa.L.Rev. 1392, 1419-20 (1975).[11] But the Advisers Act is a statute which completely omits *any* damage actions whatever, even though *otherwise analogous statutes* do not. To find a negative implication in such a case is more than a mechanical rule of construction. For while under the Securities Act the failure to include express remedies for each substantive section probably is due to considerations not relevant to the implication question, *see Note, supra,* 123

10. The situation in which there is express statutory provision for one form of proceeding, as here, for equitable but not legal actions, should be distinguished from the situation in which Congress gives broad but unspecified remedial scope to the statute, *see, e.g.,* § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). In the latter situation, implication of some private actions may be not merely consistent with the legislative purpose, but necessary in order fully to effectuate it.

11. In *Borak,* the Court relied not only on § 27's provision for "actions at law" but also on its language "brought to enforce any liability or duty created" under the Act. The Court specifically referred to *Deckert v. Independence Shares Corp.,* 311 U.S. 282, 61 S.Ct. 229, 85 L.Ed. 189 (1940), which had emphasized the same language in Section 22(a) of the 1933 Act, 15 U.S.C. § 77v(a), "to enforce any liability or duty created by this subchapter." The *Deckert* Court added: "The power to enforce implies the power to make effective the right of recovery *afforded by the Act.*" 311 U.S. at 288, 61 S.Ct. at 233. (Emphasis added).

U.Pa.L.Rev. at 1419-20, the failure to include *any* provision for damage remedies in the Advisers Act is best explained by reasons of policy which Congress deemed sound, and which would actually be undermined by the implication of a private damage action.

The Advisers Act was passed in 1940, almost four decades ago. It was designed as a threshold attempt to effect a compulsory census of investment advisers, and not as a pervasive regulatory scheme. In all these years no litigant has urged to a Court of Appeals that Section 206 of the Act is a basis for a private damage action.[12] The majority opinion suggests that when the Act first became law in 1940, Congress gave no thought to the possibility of a private right of action against investment advisers, and finds this to be an argument in favor of implication, as we have seen. The court ignores the circumstance, however, that when Congress passed the 1970 amendments, Public Law No. 91-547, 84 Stat. 1413, it specifically addressed itself to the civil liability of investment advisers. When it did, it limited that liability (a) to investment advisers who advise *investment companies* and no others, and (b) only to the extent of a breach of fiduciary duty concerning compensation for services or like payments. Investment Company Act § 36, 15 U.S.C. § 80a-35. *See Galfand v. Chestnutt Corp.*, 545 F.2d 807 (2d Cir. 1976). The implication is clear that Congress did give specific attention to investment advisers, but decided not to impose civil liability on those investment advisers who were not advisers to investment companies.

12. The issue was tendered but not passed upon in *Brouk v. Managed Funds, Inc.*, 286 F.2d 901 (8th Cir. 1961), *vacated as moot*, 369 U.S. 424, 82 S.Ct. 878, 8 L.Ed.2d 6 (1962). In his monumental treatise, Professor Loss does not even mention the possibility of a private damage action under § 206. He does indicate that § 215(b) is "relevant" to the question of civil liability, but concludes that there has been "no significant litigation." *See* L. Loss, *Securities Regulation* 1757 (1961 ed.); *id.* at 3864-65 (Supp. 1969).

It is significant also, I think, that when Congress made a thoroughgoing revision of the Advisers Act in 1960, it failed to create a single express liability nor did it amend Section 214 to include actions at law.[13] And in the 1970 amendments, Congress indicated that when it wanted to do so, it expanded the statutory relief available in the companion Investment Company Act, § 36, 15 U.S.C. § 80a-35, by providing that a court may "award such injunctive *or other relief.*" "Other relief" was added. *See Moses v. Burgin*, 1 Cir., 445 F.2d 369, 373 n.7. In addition, the recently concluded Congress had before it an amendment proposed by the Securities and Exchange Commission providing for a private damage action under the Advisers Act. It does not appear seemly to me, unless we are under an absolute compulsion to do so, suddenly to create such a claim for relief by judicial legislation, without the ability to define the outer limits of such a claim.

Congress is uniquely able to set the limits of any civil action for damages. That this is so is emphasized by the majority opinion on this very appeal. It holds that the 10b-5 claim is without merit, yet on the *same* factual allegations it supports a § 206 claim. In so doing, it circum-

13. When Congress expanded the scope of the Act in 1960, it did not alter the statutory scheme. Instead, it strengthened the enforcement powers of the SEC, *see* S.Rep. No. 1760, 86th Cong., 2d Sess. 2, 4 (1960). Pub.L. No. 86-750, §§ 2-6, 74 Stat. 885, *amending* §§ 203-04, 15 U.S.C. § 80b-3, -4. Moreover, the *Commission* was given the power to obtain injunctive relief against aiders and abettors as well as principal violators. *Id.* at § 12. Section 206 itself was amended to apply to unregistered as well as registered advisers. *Id.* at § 8. Suffice it to say that Congress was aware of the problems of enforcement and that it dealt with the problem as it saw fit. It is not for the courts to decide that this remedial scheme is still insufficient.

vents the sound policies behind the restrictions on 10b-5 claims.

Thus, for example, the 10b claim is held to have been properly dismissed because, as my brother Timbers tells us:

> "They [plaintiffs] say that they would have withdrawn from the firm in 1968 if defendants had not misrepresented the true nature of the firm's investment at that time. The short answer to this branch of plaintiff's argument is that the requirement of fraud in connection with the purchase or sale of a security is not satisfied by an allegation that plaintiffs were induced fraudulently *not* to sell their securities. *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 737-38, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975)" page 868 (emphasis in original).

I am not sure that *Blue Chip* is so limited in its application. I think that the underlying concern in *Blue Chip,* though standing was involved, was not the lack of a technical "purchase or sale," which ingenuity might have supplied, *see* 9 Cir., 492 F.2d 136, but, perhaps, the sheer inability to disprove what a plaintiff says he *would have* done if he had but known the truth. This problem is as acute in suing investment advisers as in suing offerors, perhaps even more acute in the former situation. There is a distinct danger that, by implying an open-ended private right of action, the court is giving the clients of investment advisers *carte blanche* to convert themselves from victims to defrauders. Judge Hufstedler said it well in her excellent dissenting opinion below in *Blue Chip Stamps,* 492 F.2d at 148:

> "The passive investor could always await market developments without any risk, claiming deception caused nonbuying if the value of the securities proved more promising than the offeror's glum predictions and deception caused nonselling if a rosier prospectus was followed by a market decline."

In this very case the plaintiffs received profits from the restricted letter stock and waited almost a full year until the market became unfavorable before seeking redemption of their shares.[14] They deliberately entered into a partnership that was going to operate in the most speculative of investment activities. They gave the general partners the power to invest in any kind of security, to sell short and cover both securities and commodities, to buy and sell options and to cover, to play the commodities market, to buy on margin, to lend money to partners without security, and to pledge partnership assets for loans. *See* note 1, *supra.* Even a babe in the woods would know that he was giving his money to the general partners for discretionary speculation. The purchase of unregistered stock, far from being unforeseeable, fits quite well into this plan. For, in a rising market, well-selected investment letter stock can prove profitable, and established investment bankers handle such securities on an "investment letter" basis. Given the purposes of the hedge fund and the broad powers vested in the general partners, it is hardly likely that the plaintiffs were interested in evaluating the portfolio themselves. Indeed, the plaintiffs never asked for a list of the securities held by the partnership.

The complaint does not allege self-dealing, conflict of interest, or conversion of assets, any of which would be actionable under § 10(b), if in connection with the purchase or sale of securities. *See, e. g., Bird v. Ferry,* 497 F.2d 112 (5th Cir. 1974) (conversion by salesman). To the contrary, it shows that defendants themselves invested their own

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14. Between the end of 1969 and September 30, 1970, the New York Stock Exchange composite index fell over 10%; the Dow Jones industrial average fell over 5%. Even if the hedge fund had invested in the most conservative blue-chip portfolios, therefore, plaintiffs would have suffered losses for the period.

money and the money of their families, and there is no allegation that they withdrew it. The plaintiffs prospered under this management for a considerable time when the market was good, reaping profits from the investment of unregistered securities — letter stock as well as other securities in the common portfolio. Having joined the partnership as early as 1965, they undoubtedly basked in the euphoria of the bull market described by Judge Friendly in *Levine v. Seilon, Inc.*, 439 F.2d 328, 335 (2d Cir. 1971). Conversely, however, when the market turned down, it turned down for all including the defendants.[15]

This practical consideration indicates to me, not, as it is suggested in the majority opinion, that the plaintiffs should not be given a chance to prove their case, *see* footnote 22a, but that, in the absence of a legislative determination of the policy questions involved, we are treading on dangerous ground in implying a private action under § 206 on the fact pattern alleged here, and ought instead to leave the issue to Congress. To create an analogue to Section 10(b) without the requirement that the "fraud" be "in connection with the purchase or sale" of a security hardly gives broad effect to the policy considerations so clearly expressed in

15. The majority opinion assumes that when plaintiffs discovered the "misrepresentation" they could wait until the following year to see how the market would go, because their redemption right was restricted to redemption at particular stated times. But with all respect that simply does not follow. When a person discovers that he has been defrauded, he may sue *at once* for rescission or damages, regardless of the contractual restriction. *See* Prosser on Torts § 105, at 689 (4th ed. 1971); Restatement [First] of Torts § 549 note *e* (1938). The contrary rule would substantially undermine congressional policy. As the court said in *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 213-14 (9th Cir. 1962): "The purpose of the Securities Exchange Act is to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act."

the majority opinion of the Supreme Court in *Blue Chip Stamps* and in Mr. Justice Powell's concurring opinion, as well as Judge Hufstedler's dissent in the Court of Appeals. The majority specifies no limits to the civil liability under § 206 which it is in the process of creating over this dissent. Yet, it is simply extending 10b-5 by resort to a different statute. As the Court said in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 1389, 47 L.Ed.2d 668 (1976), "We would be unwilling to bring about this result absent substantial support in the legislative history, and there is none." We do not know, if Congress creates an express private cause of action for damages under § 206, that it will not limit the right as it did with respect to § 10(b), by imposing a purchase or sale requirement, and perhaps also by defining the measure of damages and enacting a separate statute of limitations.[16]

The Commission, in its *amicus* brief, argues for an implied civil right of action for damages, on the ground that "the claim asserted by plaintiffs herein is not one that would test the *outer limits* of the cause of action created by the antifraud provisions of the federal securities laws." (Emphasis added). But what *are* the limits to what is essentially a Rule 10b-5 action, if not the prerequisite that the claim relate to the "purchase or sale of a security"? Implying a claim for relief without limitation will encourage actions against investment advisers for poor judg-

16. The SEC, for whose excellent work I have the highest admiration, has been rebuffed by the Supreme Court in its attempt to repeal the requirement of "in connection with the purchase or sale of a security." *See Blue Chip Stamps, supra*, 421 U.S. at 732, 95 S.Ct. 1917. It has also been rebuffed by this court, *see Levine v. Seilon*, 439 F.2d 328, 329 (2d Cir. 1971). And in the *Blue Chips Stamps* case, Mr. Justice Powell commented that the SEC had "joined, surprisingly" in urging expansion of the statute. 421 U.S. at 759, 95 S.Ct. 1917.

ment, disguised by pleadings subtly implying fraud and deceit. The unfounded allegation itself, contrary to the solicitude originally expressed by the SEC itself, will spell grief for the investment adviser, and the expense of defending the action will often compel settlement.[17] Each consideration is a policy ground that should be weighed. *See Blue Chip Stamps, SIPC,* and *Amtrak.* Indeed, in its early days the SEC itself was vitally concerned with these considerations militating against public disclosure.[18] This

17. Mr. Justice Rehnquist in *Blue Chip Stamps,* 321 U.S. at 740, 95 S.Ct. at 1927, stated that it was a policy concern that "even a complaint which by objective standards has very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment." And Mr. Justice Powell considered that "allowing this type of open-ended litigation would itself be an invitation to fraud." 421 U.S. at 761, 95 S.Ct. at 1937.

Similarly, in *Securities Investor Protection Corp. v. Barbour,* 421 U.S. 412, 95 S.Ct. 1733, 44 L.Ed.2d 263 (1975), Mr. Justice Marshall noted that "except with respect to the solidest of houses, the mere filing of an action predicated upon allegations of financial insecurity might often prove fatal." 421 U.S. at 422, 95 S.Ct. at 1739. He added: "These consequences are too grave, and when unnecessary, too inimical to the purposes of the Act, for the Court to impute to Congress an intent to grant to every member of the investing public control over their occurrence." *Id.* at 423, 95 S.Ct. at 1740.

18. How strikingly similar was the explanation by the SEC representative to the House of the provisions of § 210:

> "The only other provision of consequence is section 210, which in our opinion will have a very salutary effect. The investment counsels were a little concerned about the effect on their business if it got around that the Securities and Exchange Commission was conducting an investigation. In order to safeguard against this danger section 210(a) and (b) provide that there shall not be any disclosure of any investigation by the Securities and Exchange Commission until it has made up its mind that a public hearing is to be held. Then in order to safeguard them further, subsection (c), provides that the Commission can not ask these investment counsellors to disclose their clients, and what their investments are, except if there is some indication of wrongdoing. Thereafter, in connection with the investigation, they have to make the disclosure."

Hearings on H.R. 10065 before the Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. 138 (1940); *see also Senate Hearings, supra,* at 713, 715.

belies any intention by Congress to open wide private civil complaints which, in the nature of our adversary proceedings, become public property at once.

The blackmail effect of allowing customers to sue investment advisers for damages for what the customer might have done if he had but known, seems obvious for the reasons so well stated by Mr. Justice Marshall. The customer has ample relief under § 10(b), for misrepresentations made by the investment advisers in the process of getting him into the adviser's fund.[19] And if Congress wishes to go further, it can do so.

Since my brethren wish to create a new implied right of action, I have given my reasons for dissenting from their view. As indicated, I concur in the dismissal of the § 10(b) claim, but would carry over some of the reasoning to dismiss the asserted claim under § 206 as well.

19. The Commission in its *amicus* brief asserts that "this private action undeniably could be maintained [on the basis of § 10(b)] alone." This is contrary to our unanimous holding on this appeal. But we all agree that in proper circumstances, investment advisers are as liable as any other persons under § 10(b). *Cf. Superintendent of Insurance v. Bankers Life & Cas. Co.,* 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971); *Herzfeld v. Laventhol, Krekstein, Horwath & Horwath,* CCH Fed.Sec.L.Rptr. ¶ 95,660 (2d Cir., July 15, 1976); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 495 F.2d 228 (2d Cir. 1974). This fortifies the argument that there is no need for an additional judicially created remedy against advisers where the purchase or sale of securities is involved.

John M. WILSON, Plaintiff-Appellant,

v.

FIRST HOUSTON INVESTMENT CORPORATION et al.,
Defendants-Appellees.

No. 75-3422.

United States Court of Appeals,
Fifth Circuit.

Feb. 2, 1978.

Joel H. Pullen, San Antonio, Tex., for plaintiff-appellant.

Brice A. Tondre, Houston, Tex., for First Houston Investment, Walser, Allgood and Barker.

Appeal from the United States District Court for the Western District of Texas.

Before GODBOLD, TJOFLAT and HILL, Circuit Judges.

GODBOLD, Circuit Judge:

This is an appeal from the dismissal of plaintiff's suit against his investment adviser, which plaintiff sought to bring under the Investment Advisers Act of 1940, § 214, 15 U.S.C. § 80b-14 (1970) (the "IAA"), as well as Rule 10b-5, 17 C.F.R. 240.10b-5 (1977). The district court dismissed plaintiff's complaint and first amended complaint, and plaintiff appealed.

The plaintiff alleged the following facts, drawn largely from his amended complaint. For a number of years he had maintained a stock portfolio. He became dissatisfied with his investment advisers. He became interested in First Houston Investment Corporation[1] after reading two magazine

1. The defendants are First Houston Investment and three of its employees.

articles which purported to describe its investment management techniques. In particular the articles represented that First Houston utilized a system of computer analysis of the market and promptly eliminated stocks not meeting certain performance standards.

Plaintiff met with a representative of First Houston who stated that the magazine articles were accurate. As a result of these representations plaintiff executed a power of attorney giving First Houston full discretionary authority to manage plaintiff's stock portfolio, then valued at $104,358. First Houston assumed management of plaintiff's portfolio in March of 1972 and immediately converted all of his stocks into securities of its own choosing. In September 1973 First Houston notified plaintiff that it was resigning from management of the account because the account had become too small. The account was then worth $5,441 and included 1000 shares of Teleprompter stock, trading of which had been suspended. At no time did First Houston reveal to the plaintiff that the computer analysis system was no longer being used or that it had never been fully utilized.

[1] In his original complaint plaintiff sought to assert an implied right of action for damages under the IAA and a Rule 10b-5 claim as well. Motion to dismiss for lack of subject matter jurisdiction was granted. The trial court reasoned that a private right of action should not be implied under the IAA and that the complaint failed to allege a valid 10b-5 claim.[2]

2. The trial court stated that it was dismissing for lack of subject matter jurisdiction. According to the district court's analysis, the complaint more properly should have been dismissed for failure to state a claim upon which relief can be granted. *See Mobil Oil Corp. v. Kelley*, 493 F.2d 784, 786 (CA5), *cert. denied*, 419 U.S. 1022, 95 S.Ct. 498, 42 L.Ed.2d 296 (1974). As pertains to the asserted cause of action under the IAA, general federal question jurisdiction is conferred by 28 U.S.C. § 1331 (1970). *See*

Plaintiff was given leave to file an amended complaint, and he did so, again attempting to state a 10b-5 claim. However, he did not reassert his claim under the IAA, nor did he incorporate by reference the allegations of the original complaint. First Houston's motion to dismiss the amended complaint was granted.

I.

[2, 3] Plaintiff did not waive his right to appeal the order dismissing his claim under the IAA by filing an amended complaint which failed to make reference to that alleged cause of action. As a general rule an amended complaint supersedes and replaces the original complaint, unless the amendment specifically refers to or adopts the earlier pleading. *La Batt v. Twomey,* 513 F.2d 641, 651 (CA7 1975); *Cedillo v. Standard Oil Co. of Texas,* 261 F.2d 443 (CA5 1958). *See also* 6 Wright & Miller, Federal Practice and Procedure: Civil § 1476 (1971); 3 Moore's Federal Practice ¶ 15.08[7] (1974). But we hold that plaintiff, by filing an amended complaint after a dismissal with leave to amend, was not barred from raising on appeal the correctness of the dismissal order.

> A rule that a party waives his objections to the court's dismissal if he elects to amend is too mechanical and seems to be a rigid application of the concept that a rule 15(a) amendment completely replaces the pleading it amends. Without more, the action of the amending party should not result in completely denying him the right to appeal the court's ruling. By way of contrast, if the motion to dismiss is denied and defendant answers and defends on the merits, he still retains the right to object to the denial of his motion to dismiss on an appeal from the ultimate judgment. Similar principles apply to plaintiff when he unsuccessfully moves to strike a defense as legally insufficient and later serves a reply by order of the court. It therefore is not logical to deny a party the right to appeal simply because he decides to abide by the court's order and amend his pleading rather than allowing judgment to be entered against him and taking an immediate appeal.

6 Wright & Miller, Federal Practice and Procedure: Civil § 1476, at 393 (1971) (footnotes omitted). The authors refer with approval to the approach suggested in *Blazer v. Black,* 196 F.2d 139, 143-44 (CA10 1952) (citation omitted):

> [W]hile the pleader who amends or pleads over, waives his objections to the ruling of the court on indefiniteness, incompleteness or insufficiency, or mere technical defects in pleadings, he does not waive his exception to the ruling which strikes "a vital blow to a substantial part" of his cause of action.

There is authority to the contrary,[3] but such an approach spawns piecemeal appeals. We hold that the question whether a private right of action should be implied under the IAA is properly before us on appeal.

II.

[4] The broad antifraud provision of the IAA, § 206,[4] makes no express provision for a private right of action for

Abrahamson v. Fleschner, No. 75-7203, ... F.2d ....., at ..... n. 5 (CA2 1977) (the dissent and majority agree on this point). *See generally* Note, *Implying Civil Remedies from Federal Regulatory Statutes,* 77 Harv.L.Rev. 285, 287 (1963) (two possible theories of jurisdiction).

3. *Loux v. Rhay,* 375 F.2d 55, 57 (CA9 1967). *See also Sacramento Coca-Cola Bot. Co. v. Chauffeurs Local 150,* 440 F.2d 1096, 1098 (CA9), *cert. denied,* 404 U.S. 826, 92 S.Ct. 57, 30 L.Ed.2d 54 (1971).

4. 15 U.S.C. § 80b-6 (1970) provides:
"It shall be unlawful for any investment adviser, by use of

damages. But this alone does not preclude the recognition of a private right of action. *See, e. g., Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 730, 95 S.Ct. 1917, 1922, 44 L.Ed.2d 539, 546 (1975); *J. I. Case Co. v. Borak,* 377 U.S. 426, 432, 84 S.Ct. 1555, 1559, 12 L.Ed.2d 423, 427 (1964). The question is whether the implication of the cause of action is necessary to achieve the goals of Congress in enacting the legislation. *Piper v. Chris-Craft Industries, Inc.,* 430 U.S. 1, 26, 97 S.Ct. 927, 941, 51 L.Ed.2d 124, 143 (1977). In *Abrahamson v. Fleschner,* No. 75-7203, ... F.2d at ..... (CA2 1977), a majority of the panel held that a private cause of action for damages should be implied under the IAA. Judge Gurfein filed a strong dissent. Prior to *Abrahamson* this question had been considered by several district courts. *Angelakis v. Churchill Management Corp.,*

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the mails or any means or instrumentality of interstate commerce, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

"(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

"(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

"(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

[1975-1976 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 95,285 (N.D.Cal.1975) (cause of action implied); *Bolger v. Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260 (S.D.N.Y.1974) (cause of action implied); *Greenspan v. del Toro,* No. 73-638 CIV JE (S.D.Fla. May 17, 1974) (no right of action), *appeal dismissed for want of prosecution,* No. 74-2943 (CA5 Sept. 5, 1974); *Gammage v. Roberts, Scott & Co.,* [1974-1975 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 94,760 (S.D.Cal.1974) (no right of action). *See also* Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich.L.Rev. 308 (1975).

In *Piper v. Chris-Craft Industries, Inc.,* the Supreme Court was presented with the question whether a cause of action for damages should be implied under § 14(e) of the Securities Exchange Act of 1934, as amended by the Williams Act of 1968, 15 U.S.C. § 78n(e) (1970), in favor of an unsuccessful tender offeror who alleged that his bid for corporate control failed as a result of fraud on the part of the successful tender offeror and various other individuals. Chief Justice Burger, writing for the majority, noted that:

> [W]here congressional purposes are likely to be undermined absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute.

430 U.S. 1, 25, 97 S.Ct. 927, 941, 51 L.Ed.2d 124, 143 (1977). Having so stated the Court applied the following methodology in deciding the question:

> Once we identify the legislative purpose, we must then determine whether the creation by judicial interpretation of the implied cause of action asserted by Chris-Craft is necessary to effectuate Congress' goals.

Id. The Court examined the legislative history of the Williams Act and determined that Congress had intended to

protect the shareholders of target companies by regulating takeover bidders. Chris-Craft, the defeated tender offeror, was not a member of the class Congress sought to protect. Consequently an implied right of action in favor of Chris-Craft was not necessary to effectuate Congress' goals.

The Court confirmed this conclusion by applying the analysis of *Cort v. Ash,* 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975). *Cort* set out four relevant factors to be considered in deciding whether to infer a private remedy:

> First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted," *Texas & Pacific R. Co. v. Rigsby,* 241 U.S. 33, 39, 36 S.Ct. 482, 60 L.Ed. 874 (1916) (emphasis supplied)—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? See, *e. g., National Railroad Passenger Corp. v. National Assn. of Railroad Passengers,* 414 U.S. 453, 458, 460, 94 S.Ct. 690, 38 L.Ed.2d 646 (1974) (*Amtrak*). Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? See, *e. g., Amtrak, supra; Securities Investor Protection Corp. v. Barbour,* 421 U.S. 412, 423, 95 S.Ct. 1733, 44 L.Ed.2d 263 (1975); *Calhoon v. Harvey,* 379 U.S. 134, 85 S.Ct. 292, 13 L.Ed. 2d 190 (1964). And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law? See *Wheeldin v. Wheeler,* 373 U.S. 647, 652, 83 S.Ct. 1441, 10 L.Ed.2d 605 (1963); cf. *J. I. Case Co. v. Borak,* 377 U.S. 426, 434, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964); *Bivens v. Six Unknown Federal Narcotics Agents,* 403 U.S. 388, 394-395, 91 S.Ct. 1999, 29 L.Ed. 2d 619 (1971); *id.,* at 400, 91 S.Ct. 1999 (Harlan, J., concurring in judgment).

Id. at 78, 95 S.Ct. at 2088, 45 L.Ed.2d at 36-37. The Court in *Piper* found that: (1) the plaintiff was not a member of the class "for whose *especial* benefit the statute was enacted . . ."; (2) the legislative history supported the conclusion that Congress did not intend to imply a private right of action in favor of tender offerors; (3) it was not consistent with the underlying legislative purpose to imply such a right in favor of Chris-Craft; and (4) it was appropriate to relegate the plaintiff to whatever remedy is created by state law. 430 U.S. at 37-41, 97 S.Ct. at 947-949, 51 L.Ed.2d at 150-53.

In addition to applying the *Cort* factors the Court considered whether, in view of potential impact on shareholders, there was a less drastic means available for achieving the congressional goal.

> In short, we conclude that shareholder protection, if enhanced at all by damages awards such as Chris-Craft contends for, can more directly be achieved with other, less drastic means more closely tailored to the precise congressional goal underlying the Williams Act.

Id. at 40, 97 S.Ct. at 949, 51 L.Ed.2d at 152-53.

> Nor can we agree that an ever-present threat of damages against a successful contestant in a battle for control will provide significant additional protection for shareholders in general. The deterrent value, if any, of such awards can never be ascertained with precision. More likely, however, is the prospect that shareholders may be prejudiced because some tender offers may never be made if there is a possibility of massive damages claims for what courts subsequently hold to be an actionable violation of § 14(e). Even a contestant who "wins the battle" for control may well wind up exposed to a costly "war" in a later and successful defense of its victory. Or at worst—on Chris-

> Craft's damage theory—the victorious tender offeror or the target corporation might be subject to a large substantive judgment, plus high costs of litigation.

Id. at 39, 97 S.Ct. at 948, 51 L.Ed.2d at 152 (footnote omitted).

We turn to consideration of the *Cort* factors with the gloss of *Piper,* as they apply to the present case.

A. *"Class for whose* especial *benefit the statute was enacted...."*

The crucial shortcoming of the plaintiff's case in *Piper* was that plaintiff was not a member of the protected class. In the instant case, the plaintiff is a member of the class of intended beneficiaries of the IAA.

> In the opinion of the committee, the Securities and Exchange Commission, and the industry itself, this legislation is needed to protect small investors from breaches of trust upon the part of unscrupulous managements and to provide such investors with a regulated institution for the investment of their savings.

H.R.Rep.No. 2639, 76th Cong., 3d Sess. 10 (1940). This same theme appears in S.Rep.No. 1775, 76th Cong., 3d Sess. 21 (1940):

> The nature of the functions of investment advisers, their increasing widespread activities, their potential influence on security markets and the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors, convinces this committee that protection of investors requires the regulation of investment advisers on a national scale.

B. *"Legislative intent . . . to create such a remedy. . . ."*

Our understanding of the legislative purpose is consistent with the reading given it by the Supreme Court in

S. E. C. v. Capital Gains Research Bureau, 375 U.S. 180, 186-92, 84 S.Ct. 275, 279-283, 11 L.Ed.2d 237, 243-46 (1963):

> Although certain changes were made in the bill following the hearings, there is nothing to indicate an intent to alter the fundamental purposes of the legislation. The broad proscription against "any . . . practice . . . which operates . . . as a fraud or deceit upon any client or prospective client" remained in the bill from beginning to end.

Id. at 191, 84 S.Ct. at 282, 11 L.Ed.2d at 246.

The appellees argue that the omission of the phrase "actions at law" from the jurisdictional section of the Act is strong evidence that Congress did not intend to authorize federal jurisdiction over a private cause of action for damages.[5] The jurisdictional provisions of other securities acts specifically provide for jurisdiction over "actions at

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5. Section 214 of the Act states:

> "The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, *of all suits in equity* to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court."

15 U.S.C. § 80b-14 (1970) (emphasis added).

law".[6] Judge Gurfein emphasized this point in his dissent in *Abrahamson*.

> But the more cogent question is why the Advisers Act as distinguished from every other securities act, does not provide for *any express* civil liability in damages. The majority offers no explanation for such an omission which must have been a studied omission. I think it is highly relevant that in *each* of the other Acts Congress itself did provide for some *express* civil liability, yet under the Advisers Act it failed to include a single section imposing liability for damages. Congress, for example, could have provided an express damage remedy for misrepresentations in the registration statement of the advisers as it did for misrepresentations of the registration statement of the underwriter, 15 U.S.C. § 77k(a)(5). This indicates rather that, in its cautious approach to the regulation of investment advisers, Congress was not yet ready to impose *any* civil liability for damages.

..... F.2d at ..... (emphasis in original). An equally persuasive argument can be made that Congress omitted the "actions at law" language from the general jurisdictional section because the Act does not contain any express provision authorizing a private party to bring a civil action for damages. This rationale was accepted by the majority in *Abrahamson* and in *Bolger v. Laventhol, Krekstein, Horwath & Horwath*, 381 F.Supp. 260, 264-65 (S.D.N.Y 1974). The court in *Bolger* stated:

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6. The "actions at law" language is found in the following provisions: §§ 11 and 12 of the 1933 Securities Act, 15 U.S.C. §§ 77k and 77l (1970); §§ 9(e), 16(b) and 18 of the 1934 Securities Exchange Act. 15 U.S.C. §§ 78i(e), 78p(b), 78r (1970); §§ 16(a) and 17b of the Public Utility Holding Co. Act of 1935, 15 U.S.C. §§ 79p, 79q (1970); § 30(f) of the Investment Company Act of 1940, 15 U.S.C. § 80a-29(f) (1970).

> [A] plausible explanation exists for the hiatus in the language in this statute. Unlike each of the other securities laws, the Advisers Act does not contain *any* provision *expressly* authorizing a civil action by a private person injured by a violation of one of the provisions of the Act. Accordingly, it was necessary in those statutes to make reference to "actions at law" in the jurisdictional sections. Such a provision was unnecessary in the Advisers Act.

Id. at 264-65 (footnote omitted). Judge Gurfein's dissent in *Abrahamson* took exception to this analysis:

> The reason given by the majority is not persuasive, for it fails to note that in every single case in which an express civil liability is created in *any* of the Acts, the jurisdiction has *already* been stated in the very section creating the express liability. . . . The better explanation, it seems to me, for the general jurisdictional provision in each Act . . . is Congress' fear that general federal question jurisdiction under 28 U.S.C. § 1331 might not establish jurisdiction in the *federal* courts over securities law claims, particularly when the jurisdictional amount was lacking.

..... F.2d at ..... n.6 (emphasis in original).

The dissent in *Abrahamson* also attached significance to the absence of any section of the IAA that imposes liability for damages. *Id.* ..... F.2d at ..... The dissent reasoned that the omission of a section imposing liability for damages suggested that Congress, in a cautious approach to the regulation of investment advisers, was not yet ready to impose civil liability for damages. *Id.* ..... F.2d at ..... While this presentation of the former of our two choices is plausible it is no more persuasive than the reading given this matter by the majority in *Abrahamson*. We get no substantial assistance from the legislative history with respect to Congress' intentions.

C. *"Consistent with the underlying purposes of the legislative scheme. . . ."*

As we have previously stated, Congress sought to protect investors from the "problems and abuses of investment advisory services" by regulation of the industry. S.Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940). The concept of implying a private right of action for damages in favor of investors injured by violations of the Act is consistent with the remedial purposes contemplated by Congress.

In *Piper* the Supreme Court reasoned that "the Williams Act cannot consistently be interpreted as conferring a monetary remedy upon *regulated parties* . . .." 430 U.S. at 39, 97 S.Ct. at 948, 51 L.Ed at 152. Again the reasoning of *Piper* simply does not apply to the instant case where plaintiff is a member of the protected class.

D. *"The cause of action [is] one traditionally relegated to state law. . . ."*

The area of activity in question is not one, in the language of *Cort,* "[so] basically the concern of the States . . . that it would be inappropriate to infer a cause of action based solely on federal law." 422 U.S. at 78, 95 S.Ct. at 2088, 45 L.Ed.2d at 36. Federal regulation of the securities industry is very broad. An investor had little common law protection against his adviser.

> The Investment Advisers Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. . . . A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.

S. E. C. v. Capital Gains Research Bureau, 375 U.S. 180, 186, 84 S.Ct. 275, 280, 11 L.Ed.2d 237, 243 (1963). In that case the Court examined the relation between its interpretation of the IAA and common law of fraud. The Court pointed out that its conclusion—that injunctive relief was available without proof of intent to injure or evidence of actual injury—was not in derogation of the common law. *Id.* at 192, 84 S.Ct. at 283, 11 L.Ed.2d at 246. As pertains to our inquiry, the Court went on to note:

> There has also been a growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and that, accordingly, the doctrines must be adapted to the merchandise in issue.

Id. at 194, 84 S.Ct. at 284, 11 L.Ed.2d at 248.

E. *The factors applied.*

We do not find in the present case the less drastic and more closely tailored means for achieving the congressional goal which the Court found in *Piper.* Nor dc we foresee that recognition of a private right of action for damages is likely to cause investment advisers not to offer their services to the public.

[5] Thus we arrive at the ultimate question whether it is necessary to imply the cause of action to achieve the goals of Congress. We conclude that it is. Plaintiff is a member of the benefited class; the recognition of an aggrieved investor's private right of action for damages is consistent with the underlying purposes of the legislative scheme; the cause of action is not one traditionally within the province of state courts; and legislative intent either to create or deny such a cause of action is a neutral factor. Congress

sought to protect investors such as the plaintiff who have relied on the advice of investment advisers, from the possibility of overreaching and fraudulent conduct on the part of investment advisers. To deny investors a right of action for damages incurred as a direct result of fraudulent advisory practices would undermine this purpose. We find additional support in the language of the Supreme Court in *S. E. C. v. Capital Gains Research Bureau:*

> Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation "enacted for the purpose of avoiding frauds," not technically and restrictively, but flexibly to effectuate its remedial purposes.

375 U.S. at 195, 84 S.Ct at 284, 11 L.Ed.2d at 248. Finally, we perceive neither a less stringent means to achieve the congressional goal nor serious adverse impact on investors by implying the cause of action.

III.

[6] The trial court was correct in dismissing plaintiff's Rule 10b-5 claims. Plaintiff advances two theories to this court. The first is that transfer of control over his stock portfolio somehow satisfied the requirement that the alleged fraud be "in connection with the purchase and sale of securities."[7] We believe that any purchase and sale which took place incident to this arrangement was too remote to satisfy the "in connection with the purchase and sale" requirement as contemplated by *Blue Chip Stamps v. Manor*

7. On appeal plaintiff contends that the right to make purchases and sales was secured as a result of the fraud. In his complaint he pursued a slightly different approach, arguing that the purchase and sale requirement was satisfied when the defendants immediately sold all of his securities upon assuming management of his portfolio.

Drug Stores, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975).

[7] Plaintiff's second theory is that the contractual arrangement with First Houston constituted an investment contract and therefore was a security under *S. E. C. v. Howey Co.,* 328 U.S. 293, 298-99, 66 S.Ct. 1100, 1102-1103, 90 L.Ed. 1244, 1249-50 (1946). This contention was made in a proposed second amended complaint which was never filed. It was not properly before the trial court and consequently is beyond the scope of this appeal.[8]

The judgment of the trial court is AFFIRMED in part and REVERSED in part and the cause is REMANDED.

HILL, Circuit Judge, dissenting:

My brothers in the majority today have found that a private right of action exists where the United States Congress has failed to provide for one. Finding this inappropriate for several reasons, I dissent.

The Act here under investigation is the last of a series of measures designed to provide some regulation in the field of securities and similar investments. It differs noticeably from the others. The Investment Advisers Act of 1940 was designed, largely, to provide a mechanism for the Congress to obtain information about what was, at the time of enactment, a relatively new industry. 15 U.S.C.A. §§ 80b-1—80b-21. Implicit in a measure calculated to gather information is the intention of the Congress, when equipped with full information, to legislate further if the information thus obtained indicated a need for regulation. The Congress may have concluded that mandating a code of conduct and dealing which would be enforced by the Securities and

8. Whether on remand plaintiff can amend to raise this is in the discretion of the district court. Fed.R.Civ.P. 15(a).

Exchange Commission through penalties, injunctions, and the like, would be sufficient. The Congress may yet conclude that the industry would be better policed if those dealing with members of that industry have a private right of action against advisers violating the law. In any event, it is appropriate that the legislative branch make such a decision.

No legislation states that a person shall have a right of action in the federal courts under these circumstances. Yet, eminent jurists of the United States Court of Appeals for the Second Circuit have, like my brothers today, discovered the need for a private cause of action and, in a gesture somewhat patronizing of the Congress, have determined to complete the work of that body by reading one into the Act. *Abrahamson v. Fleschner,* ..... F.2d ....., at ..... (2d Cir. 1977). Perhaps the Congress should pass a law providing what my brothers find to be needed. If so, and if the inaction of the Congress leaves a void, that is regrettable.

It may be that sovereignty, like nature, abhors a vacuum. In nature, molecules of gasses mindlessly rush in to fill and destroy any vacuum that occurs. But in the political sciences and the governing arts, those of us who might be tempted to fill a vacuum are not mindless. We are given reason by which we may determine, for ourselves, whether one branch of the Government should rush into the province of another when the inaction of the other seems to create a vacuum. More than one-hundred and eighty years ago, Alexander Hamilton labeled the judiciary "the least dangerous branch" of government because it ". . . has no influence over either the sword or the purse, no direction of either the strength or of the wealth of the society, and can take no active resolution whatever. It may be truly said to

have neither Force nor Will, but merely judgment; and must ultimately depend upon the aid of the executive arm even for the efficacy of its judgments." Cooke, J. (ed.), The Federalist 522-23 (1961). As for me, I should rather leave the abhorrent vacuum than to breach the separation of powers so wisely mandated in our Constitution. I have no yearning to be patronizing of the distinguished men and women who serve in the United States House of Representatives and the United States Senate. If the need exists for a private right of action so that "private attorneys general" may help enforce the Investment Advisers Act of 1940, our Congress is quite sufficient to the task of meeting it. Even were it to be found that the Congress has attempted to abdicate this part of its legislative function to the courts, I feel that proper concern for the Constitution requires that we decline the invitation to assist in such an inappropriate way.

It may be that the Act now created by our Court is a better or more complete Act than the one actually passed by the Congress. Who knows? Its deficiency is that the judicially created Section, establishing a private cause of action, was never submitted to the people's elected representatives and adopted by them. Unlike the judiciary, the legislative branch does its work through open debate, negotiation and, often, compromise. Portions of the Investment Advisers Act of 1940 which were enacted may have been obtained at the cost of leaving out any private cause of action for damages. If so, we might even assume that no act would have passed had that compromise not been effected.[1] This possibility pretermits "judicial-legislating,"

1. Facially desirable proposals may fail because they are seen to have undesirable "side effects." Somewhat analogous is the assertion now being made by, and on behalf of, the Courts that the

a constitutional contradiction in terms. Suffice it to say that I am in complete agreement with Judge Gurfein's concurring and dissenting opinion in *Abrahamson v. Fleschner, supra* ..... F.2d at ....., concerning the impropriety of implying a private cause of action in these circumstances.

So, I respectfully dissent.

Congress has created jurisdiction in the federal courts to hear and determine a host of disputes in areas that ought not require an Article III court for their resolution. This tendency has resulted in overburdening the courts to the detriment of the quality of justice available to those litigants whose causes ought properly be before those courts. A Senator or Member of the House, heeding such warnings, might resolutely oppose any otherwise well intended measure that would add to our burden. My brothers today offer him no encouragement by, themselves, creating a new federal cause of action which the Congress never provided. It may be that what we do speaks so loudly that no one will hear what we say.

Section 206, Investment Advisers Act of 1940; 54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6:

§ 80b-6. Prohibited transactions by investment advisers.

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Aug. 22, 1940, c. 686, Title II, § 206, 54 Stat. 852; Sept. 13, 1960, Pub.L. 86-750, §§ 8, 9, 74 Stat. 887.

Section 214, Investment Advisers Act of 1940; 54 Stat. 856, 15 U.S.C. § 80b-14:

§ 80b-14. Jurisdiction of offenses and suits.

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court.

Aug. 22, 1940, c. 686, Title II, § 214, 54 Stat. 856.

Supreme Court, U. S.
FILED
JAN 4 1979
MICHAEL RODAK, JR., CLERK

APPENDIX

In the

Supreme Court of the United States

October Term, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; AND MORTGAGE TRUST OF AMERICA,

Petitioners,

—v.—

HARRY LEWIS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED MAY 5, 1978
CERTIORARI GRANTED NOVEMBER 6, 1978

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CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

April 5, 1973—Complaint filed in U.S. District Court, Southern District of New York (R. 3-22).

November 7, 1973—Stipulation and Order entered re transfer to U.S. District Court, Northern District of California (R. 1-2).

March 28, 1974—Motion to dismiss, or, in the alternative, for summary judgment and a more definite statement, with accompanying affidavits and memoranda of law, filed by defendant Transamerica Corporation (R. 115-236).

March 29, 1974—Motion to dismiss, with accompanying affidavits and memoranda of law, filed by defendants Transamerica Mortgage Advisors, Inc. (TAMA), J. Wendell Coombs, Ralph D. Wenger, Kent L. Colwell, and John R. Jensen (R. 237-273).

April 12, 1974—Motion to dismiss, or in the alternative, for summary judgment and a more definite statement filed by defendant Mortgage Trust of America (R. 274-275).

May 14, 1974—Motion to dismiss, or in the alternative, for a more definite statement filed by defendant Transamerica Land Capital, Inc. (R. 276-278).

July 24, 1974—Motion to dismiss filed by defendant John F. Havens (R. 282-284).

September 16, 1974—Memorandum in opposition to defendants' motions to dismiss, or for summary judgment, or for other relief filed by plaintiff (R. 285-321).

September 27, 1974—Hearing on defendants' motions to dismiss, or in the alternative, for summary judgment and for a more definite statement, held before the Hon. Robert H. Schnacke, United States District Court Judge (R. 380).

October 7, 1974—Order entered granting defendants' motion to dismiss with leave to amend (R. 380-382).

November 21, 1974—Order entered dismissing the case with prejudice (R. 383-384).

December 20, 1974—Notice of appeal filed (R. 385-386).

April 19, 1978—Opinion of the Court of Appeals for the Ninth Circuit filed, reversing and remanding order of dismissal.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

HARRY LEWIS, *Plaintiff,* - against - TRANSAMERICA CORPORATION, TRANSAMERICA MORTGAGE ADVISORS, INC., TRANSAMERICA LAND CAPITAL, INC., J. WENDELL COOMBS, RALPH D. WENGER, KENT L. COLWELL, JOHN R. JENSEN, JOHN F. HAVENS, ALBERT H. SCHAAF, WALTER M. S. BUCK, WARREN G. HAIGHT, MICHAEL J. CASEY and MORTGAGE TRUST OF AMERICA, *Defendants.*	73 CIV. 1448

COMPLAINT

A CLASS ACTION IS BROUGHT IN THE FOURTH THROUGH SIXTH CAUSES OF ACTION
PLAINTIFF DEMANDS A TRIAL BY JURY

Filed
U.S. District Court
Southern District of New York
April 5, 1973

Transferred to
U.S. District Court
Northern District of California
November 21, 1973

No. C-73-2180 RHS

Plaintiff, by his attorneys, Wolf Popper Ross Wolf & Jones, allege upon information and belief, except as to Paragraphs "1", "2" and "3" which are alleged upon knowledge:

FIRST CAUSE OF ACTION

1. Plaintiff is the beneficial owner of shares of Mortgage Trust of America ("MTA") and was a shareholder of MTA at the time of the transactions complained of herein and has been a shareholder continuously to date.

2. Plaintiff brings this action derivatively in the right and for the benefit of MTA.

3. This action is not a collusive one to confer on this Court jurisdiction it would otherwise not have.

4. The acts complained of herein constitute violations of Sections 203, 205, 206 and 215 of the Investment Advisers Act of 1940 as amended (15 U.S.C. §§ 80b-3, 80b-5, 80b-6 and 80b-15) (the "Advisers Act"), Rule 206(4)-1(a)(5) promulgated thereunder, and the common law. This Court has jurisdiction pursuant to Section 214 of the Advisers Act (15 U.S.C. § 80b-14), and the principle of pendent jurisdiction.

5. MTA was organized, under the sponsorship of Transamerica Corporation ("Transamerica"), as a California business trust, pursuant to a Declaration of Trust dated May 23, 1969. It was established to invest in a diversified portfolio of real estate mortgages, including construction and development mortgages, permanent first and junior mortgages, other similar loans and certain equity interests in real estate. The mortgages and loans invested in and bought and sold by MTA are securities within the meaning of Section 202(a)(18) of the Advisers Act (15 U.S.C. § 80b-2(a)(18)). In or about November, 1969, MTA issued to the public approximately 3,168,500 units of its shares of beneficial interest and 3,168,500 warrants to purchase an additional share of beneficial interest. It commenced investing operations in or about June, 1969. MTA qualified as a real estate investment trust under Sections 856 through 858

of the Internal Revenue Code of 1954, as amended, for the calendar years 1970, 1971 and 1972 and it intends to continue so to qualify in future years. MTA transacts business throughout the United States, including the Southern District of New York. Certain of the acts and transactions here complained of occurred in said District.

6. As of May 31, 1972, MTA had total assets of approximately $146,398,000 and it held real estate mortgages and loans of approximately $136,000,000. As of February 28, 1972, it had undisbursed commitments on closed loans of approximately $63,000,000.

7. There are at present issued and outstanding approximately 3,382,000 shares of MTA's beneficial interest.

8. Transamerica, a Delaware corporation incorporated in 1928, is a diversified service industry oriented holding company, engaged through its operating subsidiaries, in the insurance, real estate, finance, transportation, motion picture and related industries. Transamerica Mortgage Advisors, Inc. ("Mortgage Advisors"), a Delaware corporation organized in 1969, is a wholly-owned subsidiary of Transamerica, formed to serve as investment adviser to MTA and its shareholders. Transamerica Land Capital, Inc. ("TALC"), a Delaware corporation organized in 1964, is also a wholly-owned subsidiary of Transamerica, was engaged in the business of making real estate construction and development loans; but is presently a dormant corporation. Transamerica and its wholly-owned operating subsidiaries do or transact business throughout the United States and maintain offices in, inter alia, New York, New York. Transamerica, through Mortgage Advisors, has acted as investment adviser to MTA since the latter's establishment, pursuant to an agreement dated June 24, 1969 ("the Advisory Contract") between MTA and Mortgage Advisors. However,

neither Transamerica nor Mortgage Advisors has ever registered as an investment adviser under the Advisers Act.

9. The individual defendants, J. Wendell Coombs ("Coombs"), Ralph D. Wenger ("Wenger"), Kent L. Colwell ("Colwell"), John R. Jensen ("Jensen"), John F. Havens ("Havens"), Albert H. Schaaf ("Schaaf"), Walter M.S. Buck ("Buck"), Warren G. Haight ("Haight") and Michael J. Casey ("Casey") were the original trustees of MTA, and continue to be, or were at various times material to the matters complained of, members of the board of trustees of MTA. Defendants Coombs, Wenger, Colwell and Jensen each served simultaneously as a trustee of MTA and an officer or director or both of Transamerica, Mortgage Advisors, or one or more of the other wholly-owned and controlled subsidiaries of Transamerica. Defendants Coombs, Wenger, Colwell and Jensen are hereinafter collectively referred to as the "Interlocked Trustees." The principal occupation of each of the Interlocked Trustees is his position as an officer or director of Transamerica, Mortgage Advisors, or another Transamerica subsidiary. All of the officers of MTA are officers of other Transamerica-controlled companies and all of the operating officers of MTA, who effectively make its business decisions, are subordinates of those Interlocked Trustees who are the principal executives of MTA. None of the trustees devote a substantial portion of their time to MTA's business.

10. By virtue of the Interlocked Trustees' positions with and dependence upon Transamerica and Mortgage Advisors, the latter can and do control the acts, decisions, judgments and recommendations of the Interlocked Trustees as they affect MTA, Mortgage Advisors, Transamerica and the relationships between them.

11. The individual defendants other than the Interlocked Trustees are men of affairs actively engaged in the conduct of their own substantial business interests. None of them are or have been officers of MTA, nor are they substantial holders of MTA securities, or representatives of any significant interest in MTA independent of Transamerica and Mortgage Advisors. With respect to the affairs of MTA, they have relied on, deferred to and accepted the decisions, judgments and recommendations of MTA and the Interlocked Trustees, and have not exercised their own informed and independent judgment.

12. By virtue of the foregoing, and particularly the matter set forth in paragraphs 9 through 11 hereof, Trans-America, Mortgage Advisors and the Interlocked Trustees have the power to control and dominate the board of trustees of MTA; Transamerica and Mortgage Advisors have exercised this power ever since the formation of MTA.

13. Transamerica's control and domination has permeated the affairs of MTA since prior to its formal establishment. As the sponsor of MTA, Transamerica was instrumental in the formulating and deciding the terms of its Declaration of Trust, the Advisory Contract, and the further agreements pursuant to which MTA agreed to, and did, acquire all of its initial investments from TALC. Transamerica selected all of the original members of the board of trustees and all of the officers of MTA (all of whom were employees of Transamerica subsidiaries when selected).

14. By virtue of their offices in MTA, each of the trustees, as trustees, owe to MTA the absolute duty of loyalty, the duty to avoid all dealings involving self-dealing or conflict of interest and such other fiduciary duties as are imposed by law upon any trustee. Because of their power

of domination and control, and particularly because of their power to dictate the composition of both the board of trustees and the operating management of MTA, Transamerica and Mortgage Advisors are charged with the same fiduciary duties as are the individual trustees.

15. Transamerica, Mortgage Advisors, the Interlocked Trustees and the other individual defendants caused MTA to enter into the Advisory Contract with Mortgage Advisors, whereby Mortgage Advisors would act as the investment adviser to MTA for an initial period of approximately two years. The Advisory Contract provides that Mortgage Advisors will use its best efforts to present a suitable investment program and appropriate investment opportunities to MTA; will act generally as its investment adviser; and will perform such clerical and ministerial functions in connection with MTA's portfolio as may be agreed upon. The Contract provides that MTA will pay compensation to and expenses of Mortgage Advisors as follows:

(a) an annual fee equal to 1% of all assets invested in real estate loans and equities plus the undisbursed commitments on closed loans and other closed investments up to $100,000,000; plus a fee equal to .9% of all such assets in excess of $100,000,000 but less than $200,000,000; plus a fee equal to .8% of all such assets in excess of $200,000,000; (for the purpose of computing said monthly fee, all assets are carried at book value without reduction for any liabilities or indebtedness in respect thereof); plus

(b) incentive compensation equal to 10% of the amount by which the "net profit" of MTA for each fiscal year exceeds 8%, but does not exceed 12%, of the "average net worth" of MTA during such year; plus

(c) further incentive compensation equal to 20% of the amount by which such "net profit" exceeds 12% of such "average net worth" during such year; plus

(d) such fees as are agreed upon by Mortgage Advisors and MTA in connection with the performance by Mortgage Advisory [sic] of certain other managerial and advisory functions as provided for in the Advisory Contract and of other services not provided for in the Advisory Contract; plus

(e) expenses of Mortgage Advisors paid to trustees, appraisers, independent advisers, contractors, mortgage and property servicers, consultants, managers, officers, employees and others employed by or on behalf of MTA, and expenses of servicing mortgage loans.

The amount paid by MTA to Mortgage Advisors for each year can be as much as the greater of (a) 1½% of MTA's average net assets, but without reduction for the major expenses of MTA, including such items as the cost of borrowed money; or (b) 25% of MTA's net income, but without reduction for expenses such as interest, depreciation, depletion and amortization, maintenance of assets, taxes, legal fees, proxy expenses and other costs of holding meetings of the holders of securities of MTA.

16. The Advisory Contract was unlawful when entered into and the receipt of benefits by both Transamerica and Mortgage Advisors under that agreement and in connection with such services as it, or they, have performed for MTA is and has been unlawful pursuant to Sections 203(a) and 215(b) of the Advisers Act, 15 U.S.C. §§ 80b-3(a) and 80b-15(b), because neither Transamerica nor Mortgage Advisors has ever been registered as an investment adviser under the Advisers Act.

17. The Advisory Contract and the performance thereof are and have always been grossly unfair, unjust and inequitable to MTA and its shareholders. It represents the purchase by MTA of services to be performed by Transamerica and/or Mortgage Advisors for grossly excessive consideration and constitutes a gift and waste of the funds and assets of MTA and its shareholders. The consideration provided for and paid by MTA is so grossly excessive as to require the conclusion that the making and performance of the Advisory Contract was not due to honest errors of judgment but rather to bad faith or to a reckless indifference to the rights of MTA and its shareholders. Defendants Transamerica, Mortgage Advisors and the Interlocked Trustees are the beneficiaries of this grossly unfair, unjust and inequitable agreement. The other individual defendants have aided and abetted the making and performance of the agreement. The making and performance of the Advisory Contract constitute fraud, breach of trust and such maladministration of the affairs of MTA, and such a conscious abuse of discretion by the defendants as to work a manifest gross wrong, harm and injury to MTA and its shareholders.

18. It is evident from the following that the making and performance of the Advisory Contract are and have always been grossly unfair, unjust and inequitable to MTA and its shareholders and perpetrates a fraud upon MTA and its shareholders, who have been and are being substantially damaged as a result thereof:

(a) The total fees paid by MTA to Mortgage Advisors are grossly excessive when compared to the services received. Pursuant to the Advisory Contract these fees can be as much as 1½% per year of the average invested assets of MTA, but the same services performed by an internal staff could be obtained at a cost of less than ½ of 1% of the total assets of MTA.

(b) The basic fee to be paid by MTA to Mortgage Advisors as well as the overall limit on compensation is measured against a base which includes the undisbursed commitments on closed loans and other closed investments. However, such undisbursed commitments do not earn a rate of return high enough to justify such a fee, and in many cases they earn no return at all.

(c) In the computation of invested assets for the determination of the basic fee and the overall limit on compensation, assets are carried at book value without reduction for amortization, depreciation or depletion. This practice inherently results in overcharging because Mortgage Advisors thereby earns a fee on assets not earning a return for MTA and its shareholders.

(d) The Advisory Contract provides that MTA will pay a 10% bonus to Mortgage Advisors, as aforementioned, if the net income of MTA exceeds 8% of its average net worth during the year; and it provides for a further 20% bonus on net income in excess of 12% of such average net worth. However, it does not provide for any corresponding decreases where net income falls below the set percentage. Such incentive provisions encourage Mortgage Advisors to make high risk, high interest loans and to engage in other high risk investments which may create losses for MTA and its stockholders.

19. The Advisory Contract was initially entered into for a term of approximately two years. It can be renewed and extended for successive periods of one year each. All the trustees and Mortgage Advisors intend to renew and extend the Advisory Contract this year and in future years

for the remainder of the duration of the life of MTA, on terms which are substantially the same as now exist or on terms which will continue to be favorable to Mortgage Advisors and unfair to MTA and its shareholders.

20. By virtue of the foregoing, defendants, by participating in, approving, or acquiescing in the Advisory Contract, have breached and threaten to continue to breach their fiduciary duties to MTA and its shareholders, or have aided and abetted in the breach of said fiduciary duties to MTA and its sha.. .holders.

21. By reason of the foregoing, the defendants other than MTA have violated and will continue to violate Section 206(1) and (2) of the Advisers Act in that they have, directly and indirectly, by the use of the mails and other means or instrumentalities of interstate commerce employed devices, schemes and artifices to defraud MTA and its shareholders and they have engaged in transactions, practices and a course of business which were intended to and did operate as a fraud upon MTA and its shareholders.

22. By reason of the foregoing, the defendants other than MTA have violated and will continue to violate Section 206(4) of the Advisers Act and Rule 204(4)-1(a)(5) thereunder in that they have, directly and indirectly, by the use of the mails and means and instrumentalities of interstate commerce (a) engaged in acts, practices or a course of business which is fraudulent, deceptive or manipulative and (b) published, circulated and distributed advertisements which contained untrue statements of material facts or which were otherwise false or misleading.

23. By reason of the foregoing, MTA and its shareholders have suffered damages in the millions of dollars, the precise amount of which can only be determined upon an accounting. Furthermore, unless this Court permanently

enjoins the defendants from renewing or extending the Advisory Contract and from carrying out the terms and provisions of the Advisory Contract the aforesaid violations will continue throughout the duration of the life of MTA.

24. Plaintiff has made no demand upon the board of trustees of MTA to bring and prosecute this action. Such a demand would have been futile because the board of trustees are dominated and controlled by defendants Transamerica and Mortgage Advisors and they would not diligently prosecute an action against said defendants. Furthermore, the trustees are themselves defendants in this action. Any demand upon the trustees to redress the wrongs herein complained of would, in effect, constitute a demand that they bring action against themselves and would have been futile.

25. Demand upon the shareholders of MTA to bring this action was not made and would have been futile because:

A. Under the Declaration of Trust of MTA, the management of its affairs, including the bringing of suit, is entrusted to the trustees and not the shareholders; the shareholders cannot by resolution or otherwise require MTA or its trustees to bring an action.

B. A shareholder resolution demanding the bringing of suit would be futile since control of the action would be in the hands of the very persons alleged to be wrongdoers and cannot properly be prosecuted by them.

C. MTA has approximately 32,000 shareholders scattered over the United States. Demand upon the shareholders to take action would cast an unconscionable financial burden on the plaintiff in that the plaintiff would have to solicit proxies from all the share-

holders residing throughout the country. It would involve the conduct of a proxy fight which would entail prohibitive expenses and would cause undue loss of time and would also create a danger that some claims might eventually be barred by the Statute of Limitations.

26. Plaintiff has no adequate remedy at law.

SECOND CAUSE OF ACTION

27. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1 through 14 with the same force and effect as if set forth at length herein.

28. In or about December, 1969, and pursuant to the terms of certain agreements concerning initial investments, Transamerica, TALC, Mortgage Advisors, the Interlocked Trustees and the other individual defendants caused MTA to purchase from TALC a portfolio of first mortgages and construction and development loans, and commitments therefor for the sum of approximately $20,550,528, which constituted approximately one-half of its entire initial investment portfolio. Immediately thereafter, TALC, having thus disposed of its entire portfolio, became inactive; and substantially all of its employees became employees of Mortgage Advisors.

29. The aforesaid purchases were unlawful when made and the receipt of benefits by Transamerica, TALC or Mortgage Advisors in connection therewith is and was unlawful in that, inter alia, the transaction was permeated with self-dealing and conflict of interest; and the trustees of MTA, Transamerica and Mortgage Advisors violated their duties of undivided loyalty and failed to exercise their independent judgment solely for the best interest of MTA

in making said purchases and otherwise in acquiring MTA's initial portfolio.

30. The aforesaid purchases and agreements to purchase by MTA from TALC were grossly unfair, unjust and inequitable to MTA and its shareholders. Defendants Transamerica, TALC, Mortgage Advisors and the Interlocked Trustees are the beneficiaries of these grossly unfair, unjust and inequitable transactions. The other individual defendants participated in or aided and abetted in the making and performance of these agreements and purchases. The making and performance of those agreements constitutes a fraud, a breach of trust and such maladministration of the affairs of MTA, and such a conscious abuse of discretion by the defendants as to work a manifest gross wrong, harm and injury to MTA and its shareholders. It is evident from the following that the aforesaid agreement and purchases were grossly unfair, unjust and inequitable to MTA and its shareholders, who have been and are being substantially damaged as a result thereof:

(a) As a result of the aforesaid transactions Transamerica and TALC received large profits and other benefits including income tax benefits. Such profits exceeded those which could have been obtained by them upon the disposition of the various investments in arms' length sales to independent buyers.

(b) The mortgages and other interests purchased by Investors from TALC were selected solely by Transamerica and TALC. The trustees did not review other holdings of Transamerica and TALC nor did they consider or look for other potential investments in order to obtain the best possible portfolio for MTA; nor did they exercise their judgment and discretion as

fiduciaries in evaluating the potential investments selected by Transamerica and TALC.

(c) The mortgage and other investments purchased by MTA were of lower quality and have not performed as well as a portfolio which MTA could have purchased from third parties dealing at arms' length for the same price, nor have they performed as well as a portfolio which MTA could have purchased from Transamerica and TALC if Transamerica and TALC had offered and the trustees had selected from the best of such investments held by them.

31. Insofar as Transamerica and its affiliates received profits and other benefits including income tax benefits as a result of the aforesaid purchases and agreements to purchase, it or they received more compensation from MTA and its shareholders [sic] than was permissible under the existing agreement described in paragraph 15 of this complaint, and therefore, the receipt of such benefits was unlawful. The receipt of such benefits was also unlawful pursuant to Sections 203(a) and 215(b) of the Advisers Act, 15 U.S.C. §§ 80b-3(a) and 80b-15(b), because neither Transamerica nor Mortgage Advisors has ever been registered as an investment adviser under the Advisers Act.

32. Plaintiff repeats and realleges each and every allegation contained in paragraphs 20 through 26 with the same force and effect as if set forth at length herein.

THIRD CAUSE OF ACTION

33. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1 through 18 with the same force and effect as if set forth at length herein.

34. Pursuant to the Advisory Contract, Transamerica and Mortgage Advisors have the duty to MTA and its shareholders to serve them as their investment and financial adviser and consultant in connection with policy decisions; to provide research and economic and statistical data in connection therewith and also with respect to investments; and to consult with MTA and to furnish it with advice and recommendations with respect to making, acquiring, holding and disposing of real estate loans and other investments.

35. Transamerica and Mortgage Advisors have failed to provide MTA with the full benefit of their knowledge with respect to advice, consultation and recommendations concerning suitable real estate loans and other investments. Instead of advising MTA as to all the suitable investments which it might have made, Transamerica and Mortgage Investors [sic] have presented only some of the possibilities of which they had knowledge. They have not advised MTA as to the best investments which would have been available to MTA, but instead have acquired or retained those investments for other Transamerica affiliates.

36. The individual defendants as trustees of MTA have failed to require Transamerica and Mortgage Advisors to advise MTA as to the best, or all the suitable investments which it might have made. Instead they have allowed Transamerica to acquire or retain for the portfolios of other affiliates the best investments which should have been taken for MTA.

37. As a result of the foregoing the investment portfolio of MTA and its shareholders has been of lower quality and has not performed as well as it would have if MTA had been able to acquire the best investments known to Transamerica and Mortgage Advisors.

38. The withholding of the best investment opportunities by Transamerica and Mortgage Advisors (and the acquisition or retention thereby), the failure of the trustees to require them to advise MTA with respect to the best investments available and the receipt of benefits by Transamerica and its affiliates as a result thereof is and has been grossly unfair, unjust and inequitable to MTA and its shareholders. Defendants Transamerica, Mortgage Advisors and the Interlocked Trustees are the beneficiaries of this grossly unfair, unjust and inequitable course of conduct. Transamerica, Mortgage Advisors and the other individual defendants have participated in and aided and abetted said course of conduct. It constitutes a fraud, a breach of trust and such maladministration of the affairs of MTA, and such a conscious abuse of discretion by the defendants as to work a manifest gross wrong, harm and injury to MTA and its shareholders.

39. The aforesaid course of conduct constitutes a breach of the Advisory Contract by Transamerica and Mortgage Advisors.

40. Plaintiff repeats and realleges each and every allegation contained in paragraphs 20 through 26 with the same force and effect as if set forth at length herein.

FOURTH CAUSE OF ACTION—CLASS ACTION

41. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1, 4 through 23 and 26 with the same force and effect as if set forth at length herein.

42. Plaintiff brings this action representatively on behalf of himself and all the shareholders of Investors similarly situated.

CLASS ACTION ALLEGATIONS

43. Plaintiff brings this action as a class suit pursuant to Section 23(b)(1)(a), 23(b)(2) and 23(b)(3) of the Federal Rules of Civil Procedure.

44. There are approximately 32,000 shareholders of MTA located in various parts of the country who are members of the class. Plaintiff and his counsel, who are experienced in the litigation of class actions and litigation under the federal securities laws, will fairly and adequately protect the interests of the other shareholders of MTA similarly situated. There are numerous common questions of law and fact, including whether the agreement between MTA and Mortgage Advisors is unfair and inequitable to the shareholders of MTA and whether the acts and conduct of the defendants are in violation of Section 203, 206 and 215(b) and Rule 206(4)-1(a)(5) of the Advisers Act, and the common law. Common questions of law and fact predominate over questions affecting all the individual members of the class. The class action is superior to other methods for efficient adjudication of the claims herein since it would not be economical or feasible for the shareholders of MTA to institute individual actions against the defendants and it would be virtually impossible for all said shareholders to intervene as parties to this action.

FIFTH CAUSE OF ACTION—CLASS ACTION

45. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1, 4 through 14, 26, 28 through 31 and 42 through 44, with the same force and effect as if set forth at length herein.

SIXTH CAUSE OF ACTION—CLASS ACTION

46. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1, 4 through 18, 26, 34 through 40 and 42 through 44 with the same force and effect as if set forth at length herein.

WHEREFORE, plaintiff prays for the following relief:

(a) That the defendants be enjoined during the pendency of this action and permanently from taking any action to renew, extend, or carry out the Advisory Contract between MTA and Mortgage Advisors and Transamerica;

(b) That the Court direct and conduct a trial before the renewal or extension of said Advisory Contract and upon the conclusion of said trial, that a restraining order be issued enjoining the defendants from taking any action to renew, extend or carry out said Advisory Contract;

(c) That the Advisory Contract be set aside and, if the Advisory Contract is renewed or extended before the trial, that all such renewals or extension be set aside and that all fees and expenses and other consideration paid to Mortgage Advisors or Transamerica pursuant to said Advisory Contract and any renewals or extensions thereof be returned to MTA.

(d) That the defendants other than MTA be required to account for and pay over all damages sustained by MTA or by the plaintiff and other shareholders of MTA similarly situated, and all profits made by any of said defendants by reason of the acts complained of herein.

(e) That plaintiff be allowed the costs and expenses of this action including reasonable attorneys' fees and accountants' fees.

(f) That plaintiff have such other, further and different relief as to this Court may seem just and equitable in the premises.

WOLF POPPER ROSS WOLF & JONES

By /s/ DONALD N. RUBY
A Member of the Firm
Attorneys for Plaintiff
845 Third Avenue
New York, New York 10022
PL 9—4600

STATE OF NEW YORK
COUNTY OF NEW YORK—ss.:

HARRY LEWIS, being duly sworn, deposes and says that he is the plaintiff in the within action and has read the foregoing complaint and knows the contents thereof to be true and that the same is true to the deponent's knowledge except as to those matters therein stated to be alleged upon information and belief and as to those matters deponent believes them to be true.

/s/ HARRY LEWIS
Harry Lewis

(Jurat omitted in printing.)

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Attorneys for Defendants
Transamerica Mortgage Advisors, Inc. (TAMA)
J. Wendell Coombs, Ralph D. Wenger,
Kent L. Colwell, and John R. Jensen.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

HARRY LEWIS, Plaintiff, v. TRANSAMERICA CORPORATION, et al., Defendants.	No. C-73-2180 RHS

NOTICE OF MOTION
AND
MOTION TO DISMISS

Fed. R. Civ. P. 12

Filed
U.S. District Court
Northern District of California
March 29, 1974

To the Parties and To Their Counsel of Record:

PLEASE TAKE NOTICE that on Friday, June 21, 1974, at 9:30 a.m., or as soon thereafter as counsel can be heard, and before The Hon. Robert H. Schnacke, Judge of the District Court, Courtroom No. 5, 17th Floor, United States District Court, 450 Golden Gate Avenue, San Francisco, California, defendants Transamerica Mortgage Advisors, Inc. (TAMA), J. Wendell Coombs, Ralph D. Wenger, Kent L. Colwell and John R. Jensen, will move for an order of this Court dismissing the complaint.

The above-described motion will be made and based on the accompanying Memorandum in Support of Motion to Dismiss and Affidavit of Robert W. Cramer in Support of Motion to Dismiss; and on all of the pleadings and other papers on file in this case.

Dated: March 28, 1974.

JOHN M. ANDERSON
WILLIAM A. FALIK
LANDELS, RIPLEY & DIAMOND

Attorneys for Defendants,
Transamerica Mortgage
Advisors, Inc., (TAMA),
J. Wendell Coombs, Ralph
D. Wenger, Kent L. Colwell,
and John R. Jensen.

By /s/ WILLIAM A. FALIK
William A. Falik

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

HARRY LEWIS,
Plaintiff,
v.
TRANSAMERICA CORPORATION, et al.,
Defendants.

No. C-73-2180 RHS

ORDER

Filed
U.S. District Court
Northern District of California
October 7, 1974

The motion of defendants, Transamerica Mortgage Advisors, Inc., et al., to dismiss; and the motions of defendants Transamerica Corporation, Transamerica Land Capital, Inc., and Mortgage Trust of America, to dismiss or, in the alternative, for summary judgment and for a more definitive statement, came on for hearing on Friday, September 27, 1974.

The plaintiff, Harry Lewis, was represented by Francis J. McTernan, Esq., and Messrs. Garry, Dreyfus, McTernan, Brotsky, Herndon & Pesonen of San Francisco. The defendants, Transamerica Mortgage Advisors, Inc., J. Wendell Coombs, Ralph D. Wenger, Kent L. Colwell and John R. Jensen, were represented by John M. Anderson, Esq., and Messrs. Landels, Ripley & Diamond of San Francisco. The

defendants, Transamerica Corporation and Transamerica Land Capital, Inc., were represented by Joseph Martin, Jr., Esq., and Messrs. Pettit, Evers and Martin of San Francisco. The defendant, Mortgage Trust of America was represented by Jon F. Hartung, Esq., and Messrs. Farella, Braun & Martel of San Francisco. Defendant, John F. Havens was represented by Neil L. Shapiro, Esq., of Messrs. Cooper, White & Cooper of San Francisco.

The Court having received and considered written memoranda from the parties in support of and in opposition to the above-described motions; having heard oral argument; and having considered the affidavits, pleadings and other papers on file in this case, makes the following

ORDER:

1. The Court having determined that since Section 206 of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-6) affords no private right of action, and that consequently the Court has no jurisdiction of the plaintiff's claims, the defendants' motion to dismiss is *granted*.

2. The alternate motions of defendants Transamerica Corporation, Transamerica Land Capital, Inc., and Mortgage Trust of America for summary judgment or for a more definite statement, having become moot by reason of the foregoing order, are *denied* without prejudice.

3. Plaintiff may have 45 days from September 27, 1974, within which to file an amended complaint. If the plaintiff does not file an amended complaint within the foregoing period, then this case shall be dismissed pursuant to Rule 41(b) of the Federal Rules of Civil Procedure.

Dated: Oct 7 1974

/s/ ROBERT H. SCHNACKE
UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

HARRY LEWIS,
Plaintiff,
v.
TRANSAMERICA CORPORATION, et al.,
Defendants.

No. C-73-2180 RHS

ORDER

Filed
U.S. District Court,
Northern District of California
November 21, 1974

WHEREAS, the motion of defendants, Transamerica Mortgage Advisors, Inc., *et al.*, to dismiss; and the motions of defendants Transamerica Corporation, Transamerica Land Capital, Inc., and Mortgage Trust of America, to dismiss, or, in the alternative, for summary judgment and for a more definite statement, came on for hearing on Friday, September 27, 1974; and

WHEREAS, and pursuant to an order dated and filed October 7, 1974, this Court granted the motion of defendants, Transamerica Mortgage Advisors, *et al.*, to dismiss, but allowing the plaintiff 45 days from September 27, 1974, within which to amend; and

WHEREAS, the plaintiff, Harris Lewis, has failed to amend his complaint within the time allowed, or at all, the court makes the following

ORDER:

Pursuant to Fed. R. Civ. P. 41(b), this case is dismissed with prejudice as against each and all of the defendants, and each and all of the defendants are awarded their respective costs.

Dated: Nov 21 1974

/s/ ROBERT H. SCHNACKE
UNITED STATES DISTRICT JUDGE

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HARRY LEWIS,
Plaintiff-Appellant,
v.
TRANSAMERICA CORP., et al.,
Defendants-Appellees.

No. 75-1285

OPINION RE APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

Filed
U.S. Court of Appeals
For the Ninth Circuit
April 19, 1978

Appeal from the United States District Court
For the Northern District of California

Before: BROWNING and WALLACE, Circuit Judges, and EAST,* Senior District Judge

EAST, Senior District Judge:

The plaintiff-appellant Harry Lewis (Lewis) appeals from an order entered by the District Court on November 21, 1974 dismissing the action with prejudice on the grounds "Section 206 of the Investment Advisers Act of 1940 (15

*Honorable William G. East, Senior United States District Judge for the District of Oregon, sitting by designation.

U.S.C. § 80b-6) [Advisers Act] affords no private right of action, and that consequently the Court has no jurisdiction of the plaintiff's claims . . . ." We vacate the order and remand.

Lewis' Complaint:

Lewis is a shareholder of the defendant-appellee Mortgage Trust of America (Trust), and his complaint presents three shareholder derivative and three class actions for violation of the Advisers Act and common law fiduciary duties. He alleges in substance:

The Trust was organized as a California business trust and is qualified as a real estate investment trust under the Internal Revenue Code. It invests primarily in construction and development first mortgage loans. None of its investments have been listed on any national or local securities exchange or offered for trading in any over-the-counter market. The original officers and employees of the Trust were formerly associated with the defendant-appellee Transamerica Land Capital, Inc. (TALC), a "first tier" subsidiary of the defendant-appellee Transamerica Corp. (Transamerica). The Trust purchased from TALC its original portfolio of mortgages. The defendant-appellee Transamerica Mortgage Advisors, Inc. (Mortgage Advisors), a Delaware corporation and a "third tier" subsidiary of Transamerica, is retained as the Trust's mortgage adviser. It advises the Trust on various real estate investments and administers its day-to-day operations. The Trust is and always has been Mortgage Advisors' only client. Transamerica is the parent of Mortgage Advisors and the sponsor of the Trust. Nine individual defendants-appellees are trustees of the Trust.

Lewis' Issue on Review:

Does the Advisers Act give rise to an implied private right of action for injunctive relief and damages on behalf of persons injured by violations of its provisions?

Defendants-Appellees' Issues on Review:

In view of the naked holding of a lack of jurisdiction, the District Court did not reach the following issues which the defendants present for review:

(1) Whether the several defendants fall within the scope of the Advisers Act.

(2) Whether the class action claims are proper.

(3) Whether Lewis has standing to maintain a derivative action without having made a demand upon the trustees to act.

Discussion:

Since the District Court did not first consider and adjudicate those issues raised by the defendants, we decline to now do so. *Singleton v. Wulff*, 428 U.S. 106, 120, 96 S.Ct. 2868, 49 L.Ed.2d 826 (1976); *Hector v. Wiens*, 533 F.2d 429, 433 (9th Cir. 1976).

At the time of the District Court's consideration of its ultimate order of dismissal of the action for lack of jurisdiction, the circuit case law on the issue was nil. At that time only the following District Court decisions were available for consideration: *Bolger v. Laventhol, Krekstein, Horwarth & Horwarth*, 381 F.Supp. 260, 263 (S.D.N.Y. 1974) (recognizing an implied private right of action). *Greenspan v. del Toro*, No. 73-638 CIV JE (S.D. Fla. May 17, 1974), *appeal dismissed for want of prosecution*, No. 74-2943 (5th Cir. Sept. 5, 1974); and *Gammage v. Roberts, Scott & Co.*, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,761 (S.D. Cal. 1974) (no private right of action).

We now have the benefit of the decisions of the Courts of Appeals for the Fifth and Second Circuits finding an implied private right of action under the Advisers Act. *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978); *Abrahamson v. Fleschner*, 568 F.2d 862 (2d Cir. 1977).[1]

Without reiterating their able discussions, we adopt the rationale of the majorities in *Abrahamson* and *Wilson*. Accordingly, we hold that the implication of a private right of action for injunctive relief and damages under the Advisers Act in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation. The District Court holds subject matter jurisdiction to en-

---

1. See the following for support of the majorities' rationale in *Abrahamson* and *Wilson*; *J. I. Case Co. v. Borak*, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964); *Cort v. Ash*, 422 U.S. 66, 78, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975); and *Bolger's* clarifying discussion of the goal of Congress in enacting the Advisers Act, 381 F. Supp. at 263.

The following District Courts have, since the entry of the order of dismissal in this case, held that an implied right of private action exists under the Advisers Act: *Jones v. Equitable Life Assurance Society*, 409 F. Supp. 370 (S.D.N.Y. 1975), *accord, Angelakis v. Churchill Management Corp.*, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,285 (N.D. Cal. 1975); and *Sullivan v. Chase Investment Services of Boston, Inc.*, 434 F.Supp. 171 (N.D. Cal. 1977).

The Securities Exchange Commission has submitted to Congress a proposed amendment to the Advisers Act which provides explicitly for a private right of action under the Advisers Act. See Investment Advisers Act Release No. 491, 8 SEC Docket 744 (Dec. 15, 1975). In announcing its proposal, the SEC repeated its view that the existing language was sufficient to imply a private right of action. Its proposal was intended to put to rest those few decisions which have found no implied right of action. "The commentators who have reviewed these decisions agree that a private right of action should be implied under the Advisers Act. Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 Mich. L. Rev. 308 (1975); Lybecker, Advisers Act Developments, 8 Review of Securities Regulations 927, 934 (April 23, 1975); Note, *Bolger v. Laventhol, Krekstein, Horwarth & Horwarth: Private Rights of Action Under the Investment Advisers Act*, 48 Temple L.Q. 433 (1975)." *Abrahamson*, 568 F.2d at 872, n. 17.

tertain such actions and pendens state claims pursuant to 28 U.S.C. § 1331.[2]

The District Court's order of dismissal is vacated and the cause remanded to the District Court for further proceedings consistent herewith.

ORDER OF DISMISSAL VACATED AND CAUSE REMANDED.

WALLACE, Circuit Judge, Dissenting:

This case presents an issue of first impression in our circuit on which reasonable minds may differ. I recognize the strength of the opinions and the articles cited by the majority. I am persuaded, however, by the analysis of Judge Gurfein in *Abrahamson v. Fleschner,* 568 F.2d 862, 879 (2d Cir. 1977) (concurring and dissenting), and therefore respectfully dissent.

---

2. "The trial court stated that it was dismissing for lack of subject matter jurisdiction. According to the district court's analysis, the complaint more properly should have been dismissed for failure to state a claim upon which relief can be granted. *See Mobil Oil Corp. v. Kelley,* 493 F.2d 784, 786 (CA5), *cert. denied,* 419 U.S. 1022, 95 S. Ct. 498, 42 L.Ed.2d 296 (1974). As pertains to the asserted cause of action under the IAA, general federal question jurisdiction is conferred by 28 U.S.C. § 1331 (1970). *See Abrahamson v. Fleschner,* 568 F.2d 862, at 867 n. 5 (CA2 1977), (the dissent and majority agree on this point)." *Wilson,* 566 F.2d at 1237 n. 2.

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; and MORTGAGE TRUST OF AMERICA,

Petitioners,

vs.

HARRY LEWIS,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Opinions Below

The opinion of the District Court, incorporated in its Order (*Pet. App.* 6-8), and a further Order of the District Court (*Pet. App.* 10-11), are unreported.

The opinion of the Court of Appeals has not yet been reported officially, or otherwise.

The majority opinion of the Court of Appeals adopts the rationale of the majority opinions in *Abrahamson* v. *Fleschner,* 568 F.2d 862 (2d Cir. 1977), and *Wilson* v. *First Houston Investment Corp.,* 566 F.2d 1235 (5th Cir. 1978), in each of which cases the Court of Appeals recognized

an implied private right of action arising under the anti-fraud provisions of the Investment Advisers Act of 1940 ("Advisers Act"). The dissenting opinion relies upon the analysis presented by the dissenting opinion in *Abrahamson* v. *Fleschner, supra.*

The petition for certiorari that was filed in the *Abrahamson* case was denied by this Court, *sub nom. Malcolm K. Fleschner, et al.* v. *Robert Abrahamson et ux,* No. 77-1279, on May 15, 1978.

Jurisdiction

The jurisdictional requisites are adequately set forth in the Petition at page 2.

Question Presented

Did the Court of Appeals correctly hold that a private cause of action may properly be implied under the Advisers Act in favor of appropriate plaintiffs, such implication being necessary to achieve the goals of Congress in enacting that statute; and thus correctly determine that the District Court had erred in dismissing the complaint in a shareholders' derivative and representative action brought under that statute on the grounds that the federal courts lacked subject matter jurisdiction over the claims asserted?

Statutes

The pertinent provisions of the Investment Advisers Act of 1940, Section 206 (54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6) and Section 214 (54 Stat. 856, 15 U.S.C. § 80b-14), are set forth in Petitioner's Appendix, at pages 77-78.

Statement of the Case

Respondent Harry Lewis brought this suit in the United States District Court for the Southern District of New York in April 1973, as a shareholder of the petitioner Mortgage Trust of America ("MTA"), derivatively on behalf of MTA and representatively on behalf of all similarly situated shareholders of MTA. MTA is a real estate investment trust, within the meaning of Sections 856-858 of the Internal Revenue Code of 1954, as amended; and its shares of beneficial interest are and were at the time when the action was instituted listed and traded on the New York Stock Exchange. Petitioner Transamerica Mortgage Advisors, Inc. ("TAMA"), a third-tier subsidiary of petitioner Transamerica Corporation, is the investment adviser of MTA, pursuant to an investment advisory agreement; and advises MTA on its real estate investments as well as administering its day-to-day operations. TAMA was and is the sole investment adviser of MTA, which is in turn TAMA's sole client. Petitioner Transamerica Corporation is the parent of TAMA and the sponsor of MTA. Petitioner Transamerica Land Capital, Inc. ("TALC"), is a first-tier subsidiary of Transamerica Corporation. MTA purchased its original investment portfolio of mortgages from TALC, and MTA's original officers and employees had previously been associated with TALC. The individual defendants, not all of whom are petitioners here, were trustees of MTA; several of whom had also been affiliated with Transamerica Corp., TAMA or other subsidiaries of Transamerica Corp.

The Complaint set forth six causes of action; the first three being stated as derivative causes, and the latter three being restatements of the first three, set in representative form.

The first and fourth causes of action sought equitable relief and damages for the harm alleged to have arisen from fraudulent and unfair conduct involved in the making and subsequent performance of the investment advisory agreement between MTA and TAMA. Transamerica Corporation allegedly controlled and directed the formation of both MTA and TAMA and the formulation and performance of this contractual relationship. In essence, these causes of action asserted that, in consequence of the domination and control exercised over MTA by Transamerica, TAMA, *et al.*, the former entered into essentially a contract of adhesion with TAMA; under which it was required to pay, and did pay, advisory fees that were grossly excessive to the point of fraudulence and that were computed on bases that encouraged fraud and overreaching by TAMA and others so as to maximize such fees.

The second and fifth causes of action claim fraudulent conduct as well as unfairness in respect of the transactions by which MTA, at the commencement of its operation as a real estate investment trust, was caused by petitioners Transamerica, TAMA and TALC to acquire its original investment portfolio from the latter.

The third and sixth causes of action alleged, in essence, that because of the control exercised by Transamerica Corporation and its affiliates, including TAMA, and because of the inherent conflicts of interest between those petitioners and MTA, MTA did not receive the investment advice to which it was entitled from TAMA. It is asserted that Transamerica and its affiliates had been allowed to retain the best investment opportunities, within the range of MTA's investment potentialities, which had come to the attention of TAMA.

Jurisdiction over each of these causes of action was based on the Advisers Act, including particularly Sections 206 and 214 thereof.

In March 1974, shortly after the case was transferred, by stipulation of the parties, to the Northern District of California, petitioners (and the other defendants below) moved for dismissal of the Complaint, pursuant to Rules 12(b)(6) and 56 of the Federal Rules of Civil Procedure. While a variety of grounds for the relief sought were advanced, the District Court reached only one of them. In a brief order, it determined that "since Section 206 of the Investment Advisers Act of 1940 affords no private right of action, and that consequently the Court has no jurisdiction of the plaintiff's claims, the defendants' motion to dismiss is granted." (*Pet. App.* 7; emphasis omitted.)

Petitioners' additional motions for summary judgment and for a more definite statement were denied as "moot." While the order of the District Court granted respondent leave to amend, he declined to do so; and an order dismissing the action with prejudice was entered on November 21, 1974.

Respondent appealed to the Court of Appeals.

On April 19, 1978, the Court of Appeals reversed, the majority explicitly adopting "the rationale of the majorities in *Abrahamson* and *Wilson*." (*Pet. App.* 4.)

The Court specifically refused to consider the additional issues that had been raised in the District Court by petitioners, since that Court had not determined them, but had dismissed on the basis of a "naked holding of a lack of jurisdiction. . . ." (*Pet. App.* 3.) The Court of Appeals held only that:

> "Accordingly, we hold that the implication of a private right of action for injunctive relief and damages under the Advisers Act in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation. The District Court holds subject matter

jurisdiction to entertain such actions and pendens state claims pursuant to 28 U.S.C. § 1331." (*Pet. App.* 4-5.)

The dissenting Judge, in a single paragraph opinion, conceded that "reasonable minds may differ" upon the issue presented; and dissented on the basis of the dissenting opinion in the *Abrahamson* case (*Pet. App.* 5.)

Reasons for Denying the Writ

The Petition for Certiorari here specifically, and almost entirely, relies upon the reasoning of the petition for certiorari in *Fleschner* v. *Abrahamson,* Dkt. No. 77-1279; which petition was denied by this Court on May 15, 1978. This case, presenting the same central question of law, similarly presents no greater reason for review by this Court than was present in the *Abrahamson* case. If anything, this case is far less appropriate for a grant of *certiorari,* in that it reaches this Court upon an extremely limited and undeveloped record; that is, upon a terse order of the District Court dismissing for want of subject matter jurisdiction, and a brief opinion of the Court of Appeals, vacating that dismissal in reliance upon the analysis of the majorities in *Abrahamson* and in *Wilson* v. *First Houston Investment Corp., supra.* The reasons for denying for writ here are, we respectfully submit, ably and forcefully set forth in the Brief for Respondents in Opposition to Certiorari in *Abrahamson,* particularly at pages 8 through 18; and, rather than repeating them at length, we respectfully ask that the Court refer thereto.

In addition, we submit that the additional arguments raised by petitioners here add nothing of significance to the arguments made, and disposed of, by this Court, with respect to the *Abrahamson* case.

(1) Each of the three Courts of Appeals that have had occasion to consider the issue has determined that it is appropriate to imply a private right of action under the antifraud provisions of the Advisers Act. Essentially, in so determining, the Courts of Appeals for the Fifth and the Ninth Circuits have followed the studious and reasoned analysis of the majority of the Second Circuit in the *Abrahamson* case. The mere fact that, in each case, there was a dissenting opinion, creates no basis for the grant of *certiorari* here. Petitioners' argument that the implication of the private right of action so recognized "scuttles the limitations on securities law actions," which this Court established in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), is aptly and dispositively answered by the opinion of Judge Timbers in *Abrahamson,* where he states:

> "The *Blue Chip* decision was based on the *express language* of Section 10(b) and Rule 10b-5 requiring a fraud 'in connection with the purchase or sale of any security.' *Neither Section 206 of the Advisers Act nor Rule 206(4)-1 contains any such requirement.* While the Court stated in *Blue Chip* that the purchaser-seller limitation under Section 10(b) protected against vexatious and speculative claims, it did not say or suggest that *any* claim would be too speculative for recovery under the other securities acts unless the plaintiff was a purchaser or seller. Indeed the Court acknowledged that provisions of the other securities acts afford rights of action to persons who are not purchasers or sellers. 421 U.S. at 733-34." (568 F.2d at 877; emphasis in original; footnote omitted.)

Moreover, implication of a private right of action under the antifraud provision of the Advisers Act does not create the limitless class of plaintiffs that this Court saw as poten-

tially arising should persons who had neither purchased nor sold securities been permitted to bring actions under Section 10(b) or Rule 10b-5 of the Securities Exchange Act of 1934. In the context of the Advisers Act, it must be plain that a remedy under Section 206 would arise only where there was, or had been, an actual advisory relationship; whereas, in the context of *Blue Chip*, a suit could have been based, absent the purchaser-seller requirement, on the absence of any relationship or transaction.

In addition, each of the Courts of Appeals that have found the implied right of action under the Advisers Act to exist has adhered to the four-element test laid down by this Court in *Cort* v. *Ash*, 422 U.S. 66, 78 (1975), for determining whether a private remedy should be implied pursuant to a statute that does not expressly provide such a remedy. Particularly inasmuch as *Cort* v. *Ash* was decided subsequent to the *Blue Chip* case, a careful adherence to the standards suggested in the *Cort* case cannot and should not be taken as an evasion of the mandate of *Blue Chip*.

Nothing is added to petitioners' argument by their claim for special attention to the argument, made by petitioners in *Abrahamson*, that it is important that Congress has not provided an express private remedy under the Advisers Act. No negative implication can be drawn concerning the intention of the Legislature from such inaction. Congress has surely been aware of the developing law of implied private remedies under the general antifraud provisions of the federal securities laws. Given such awareness, its inaction is far too slender a reed upon which to build an edifice of negative intention.

Petitioners' plaint that the Second, Fifth and Ninth Circuits have "uncovered an unspoken private legal right" is simply a diffuse protest against the entire doctrine that

implied civil remedies may be derived from statutes creating substantive law. We submit that this proposition is too well settled to warrant further discussion here.

(2) Petitioners' argument that implication of a private right of action under the Advisers Act unnecessarily and improperly brings into the federal courts claims that are inherently and traditionally state law claims is wholly insupportable. Congress, in enacting that statute, explicitly declared its finding that "investment advisers are of national concern," noting, *inter alia*, that both their advisory function and the transactions by which they entered into agreements involved "means and instrumentalities of interstate commerce"; that their advisory functions "customarily relate to the purchase and sale of securities traded on national securities exchanges . . ."; and that "the foregoing transactions" substantially affected interstate commerce and national securities exchanges as well as other securities markets. (Investment Advisers Act, § 201 (15 U.S.C. § 80b-1).) By virtue of Section 214 of the Advisers Act, the federal district courts are given "jurisdiction of violations of this subchapter or the rules, regulations or orders thereunder. . . ." (15 U.S.C. §80b-14.) Section 215 of the Act declares void "every contract made in violation of any provision of this subchapter. . . ." (15 U.S.C. § 80b-15(b).) Section 206 of the Act makes it a violation of federal law for an investment adviser to "defraud," to engage in any "transaction, practice or course of business which operates as a fraud or deceit," or "to engage in any act, practice or course of business which is fraudulent, deceptive or manipulative." (15 U.S.C. § 80b-6(1), (2), (4).) It is altogether too clear that Congress had determined that the relationship of investment adviser and advisee, and the conduct of investment advisers toward clients, prospective clients and the investing public, was in fact a matter of federal regulatory concern. This was clearly

recognized by this Court in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963); and most cogently and irrefutably elucidated in the *Abrahamson* case. (See *Pet. App.* 29-31.)

Since fraud and other violations of the Advisers Act are clearly a matter of federal concern, and within the jurisdiction of the federal courts, petitioners' effort to raise the shibboleth of "undue burden" on the federal courts is an invitation to the judiciary to ignore its responsibilities under the Act. Given the obvious federal concern, the suggestion that the federal courts should avoid adjudication of these matters in order to reduce their workload, whatever the merits of the claims that have been, or may be, asserted, is unworthy of serious consideration. Petitioners purport to see a real burden upon the federal courts, especially in actions brought by shareholders of real estate investment trusts, against those trusts "and" their advisers. In support of this argument, they point to a total of twelve such actions, brought since 1973. (*Pet. for Cert.* 6.) Thus, petitioners argue that the commencement of approximately two actions per year over a six-year span, challenging the investment advisory contracts under which real estate investment trusts have operated, imposes an insupportable burden upon the federal courts. We respectfully submit that this suggestion is unworthy of serious consideration.

(3) Petitioners' final point to which they "urge special attention" is no more than a tired rehash of a settled issue. Surely, where, as in the cases upholding the existence of a private right of action under the Advisers Act, the courts have carefully followed and applied the criteria set down by this Court in *Cort* v. *Ash, supra,* there is no "classic confrontation" with the "express words of a statute." (See *Pet. for Cert.* 7.) As was cogently pointed out in the

Brief for Respondents in Opposition in the *Abrahamson* case:

> "That argument would lead to the illogical conclusion that no *implied* rights exist unless *express* rights are first granted. The law is otherwise. The doctrine of implied private rights of action arose precisely *because* statutes obviously designed to protect certain classes of persons omitted to provide those persons with express private remedies. See, e.g., *Texas & Pacific R.R. Co.* v. *Rigsby,* 241 U.S. 33 (1916)." (At 14; emphasis in original.)

We submit that, so long as the recognition of implied private rights of action occurs in a manner consistent with this Court's prior rulings, the concern expressed by Mr. Justice Frankfurter in *Palmer* v. *Massachusetts,* 308 U.S. 79, 83 (1939) (cited in Petition for Writ of Certiorari, at 7), is fully vindicated.

Finally, we submit that the decision of the Court of Appeals in this case, following, as it does, the rulings and rationale of the *Abrahamson* case and the *Wilson* case, is wholly consistent not only with the purposes of the Advisers Act and the prior rulings of this Court, but is consistent with the long line of decisions recognizing such private rights of action under the Investment Company Act, as well as under the antifraud and other provisions of the Exchange Act. It is, as respondents point out in their brief in *Abrahamson,* "the reasoned and inevitable product of more than forty years' experience with the federal securities laws." (At 8.)

In the present case, the Court of Appeals for the Ninth Circuit has held no more than that a private right of action may be implied, for the benefit of a proper plaintiff, under

the Investment Advisers Act of 1940. No other issue is presently before this Court, nor is any other issue proffered directly or indirectly by petitioners ripe for review. *A fortiori,* no issue is presented by the instant Petition that was not presented and considered in the *Abrahamson* case. There is nothing new, or novel, in the record of this case to date, or in the decision of the Court of Appeals, giving rise to any reason for review by this Court.

CONCLUSION

For the foregoing reasons, and for the reasons stated in the Brief for Respondents in Opposition in *Fleschner* v. *Abrahamson,* Dkt. No. 77-1279, the Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit should be denied.

Respectfully submitted,

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; AND MORTGAGE TRUST OF AMERICA,

Petitioners,

—v.—

HARRY LEWIS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion of the Court of Appeals (A. 28)[1] is reported at 575 F.2d 237 (9th Cir. 1978). The relevant orders of the District Court (A. 24, 26) are not reported.

The majority and dissenting opinions of the Court of Appeals adopt the majority and dissenting opinions of the

1. All "A. . ." references are to the Single Appendix.

Court of Appeals for the Second and Fifth Circuits in *Abrahamson v. Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), and *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), respectively. A petition for certiorari has been filed in *Wilson* and is before this Court as Dkt. No. 77-1717.

JURISDICTION

The judgment of the Court of Appeals was entered on April 19, 1978. A petition for a writ of certiorari was filed on May 5, 1978, and was granted on November 6, 1978. The jurisdiction of this Court is based on 28 U.S.C. § 1254(1) (1966).

QUESTION PRESENTED

May a private right of action at law for damages be implied under the Investment Advisers Act of 1940?

STATUTES INVOLVED

Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1971)[2] is set forth in *Addendum A* to this brief. Section 214 of the Investment Advisers Act, 15 U.S.C. § 80b-14 (1971)[3] is set forth in *Addendum B*.

STATEMENT

Petitioners include a real estate investment trust, five individuals, and four corporations.

Mortgage Trust of America—Mortgage Trust of America is a real estate investment trust qualified under applicable provisions of the Internal Revenue Code. (R. 179-

2. Aug. 22, 1940, c. 686, Title II, § 206, 54 Stat. 852; Sept. 13, 1960, Pub.L. 86-750, §§ 8, 9, 74 Stat. 887.

3. Aug. 22, 1940, c. 686, Title II, § 214, 54 Stat. 856.

180).[4] The Trust's business is limited to investments in real estate, primarily construction and development loans secured by mortgages. (R. 179-180, 182-186, 271-272). None of the Trust's mortgages or other investments have ever been listed on any national or local securities exchange, or offered for trading in any over-the-counter market. (R. 179-180).

The Trustees—The five individual petitioners are trustees of Mortgage Trust of America. The Trust has nine trustees.[5] A majority of the trustees has always been independent of Transamerica Corporation and its subsidiaries. (R. 5-6, 179-181, 271-273).

The Corporations—Transamerica Mortgage Advisors, Inc. (TAMA) is a Delaware corporation and a wholly-owned subsidiary of Transamerica Mortgage Company. Transamerica Mortgage Company is a wholly-owned subsidiary of Transamerica Land Capital, Inc., which in turn is a wholly-owned subsidiary of Transamerica Corporation (R. 179).[6]

TAMA is retained by Mortgage Trust of America as its adviser. The Trust is TAMA's *only* client. TAMA advises the Trust on various real estate investments, and administers the Trust's day-to-day operations. TAMA has never had another client. TAMA has never advertised its serv-

4. All "R. . ." references are to the Ninth Circuit Clerk's Record on Appeal, certified and transmitted to this Court on November 13, 1978.

5. All nine trustees of Mortgage Trust of America are named in the complaint, but only Messrs. Colwell, Coombs, Havens, Jensen and Wenger have been served and made parties to the litigation. (R. 3).

6. When this litigation began, Transamerica Mortgage Company was known as Bankers Mortgage Company. Bankers Mortgage was a wholly-owned subsidiary of Bankers Land Investment Corporation, in turn a wholly-owned subsidiary of Transamerica Corporation.

ices, solicited additional clients, or held itself out in any way as a public investment adviser. (R. 271-272).

The Litigation—Harry Lewis filed suit against petitioners in the United States District Court for the Southern District of New York on April 5, 1973. He based jurisdiction on the Investment Advisers Act of 1940.

Lewis's complaint sets forth six claims for relief. The first three are derivative, and the last three purport to be class actions on behalf of Mortgage Trust of America's shareholders. The first (derivative) and fourth (class) allege that petitioners TAMA and Transamerica Corporation failed to register as required by the Investment Advisers Act and that certain fees paid TAMA by the Trust were excessive. The second (derivative) and fifth (class) claims allege unfairness and conflicts of interest in the Trust's purchase of its initial loan portfolio from Transamerica Land Capital. The third (derivative) and sixth (class) claims for relief allege breach of fiduciary duty and breach of trust by TAMA and Transamerica Corporation in rendering investment advice to Mortgage Trust of America. (R. 3-22).

Pursuant to stipulation and applicable provisions of the Judiciary Code,[7] the case was transferred to the Northern District of California in November, 1973.

On March 28, 1974, petitioners asked that the case be dismissed. Petitioners argued that the Investment Advisers Act does not afford a private right of action; that the Act does not apply in any event; and that Lewis had not adequately excused his failure to make demand on the trustees. (R. 240-270).

Petitioners' motions to dismiss were heard September 27, 1974. The District Court concluded that the Investment Advisers Act of 1940 did not afford a private right of action.[8] A formal order dismissing the complaint with leave to amend was entered on October 7, 1974. (A. 24). Lewis declined to amend and the case was dismissed with prejudice on November 21, 1974. (A. 26).

7. *See*, 28 U.S.C. § 1404(b) (1976).

Lewis appealed.

The Court of Appeals (2-1; Wallace, J., dissenting) reversed, and held that "the implication of a private right of action for injunctive relief and damages under the [Investment Advisers Act] in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation." (A. 31). The majority adopted the reasoning of the majorities in *Abrahamson v. Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), and *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978).

In dissent, Judge Wallace adopted Judge Gurfein's dissent in *Abrahamson v. Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978). (A. 32).

Petitioners sought a writ of certiorari. Their petition was granted on November 6, 1978.

SUMMARY OF ARGUMENT

The Investment Advisers Act of 1940 contains no language expressly authorizing a private right of action for money damages. The remedial provisions of the Advisers Act are limited to enforcement actions by the Securities Exchange Commission.

The language of the Advisers Act differs significantly from the other federal securities acts in that, unlike the

8. The District Court did not consider petitioners' other arguments for dismissal, and for that reason the court below declined to rule on those arguments. (A. 30).

other acts, the Advisers Act does not expressly authorize actions at law in the federal courts.

Since Congress did not expressly provide a private right of action under the Advisers Act, the issue is whether this Court may properly *imply* a private right of action for money damages.

The considerations set forth in *Cort v. Ash*, 422 U.S. 66 (1975), lead to the conclusion that it is not appropriate to imply a private right of action for money damages under the Advisers Act. There is no basis for a conclusion that the Act was passed for the "special benefit" of investors seeking money damages. The legislative history indicates that Congress deliberately excluded reference to "actions at law" when the Act was originally enacted and has rejected private damage actions in subsequent amendments to the Act. Implying a private action for money damages under the Act is not "necessary" to effectuate the main purposes of the Act. The SEC already has a wide range of enforcement powers available. Finally, conduct of the sort sought to be prescribed in this action has been traditionally and adequately monitored by the state courts in actions for fraud, negligent misrepresentation and breach of fiduciary duty.

There are, in addition, important practical reasons why a private right of action should not be implied under the Investment Advisers Act. Allowing the maintenance of private actions under the Advisers Act would undermine the limitations on federal securities litigation recently recognized in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) and *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). If, for example, private actions for money damages were authorized under the Advisers Act, a disgruntled investor could bring suit against an investment adviser in federal court without having to show that the

wrongdoing occurred in connection with the purchase or sale of a security, or that the adviser intended to defraud, deceive, or manipulate.

Implying a private right of action under the Investment Advisers Act of 1940 is not warranted by the language of the Act, is not necessary to achieve the purposes of the Act, and would undermine well-reasoned limitations on federal court actions by investors in securities.

ARGUMENT

The Investment Advisers Act of 1940 does not expressly authorize a private right of action at law for damages.[9] The question presented is whether a private right of action at law for damages may be *implied* under the Advisers Act.

In *Cort v. Ash*, 422 U.S. 66 (1975), this Court set forth four factors relevant to determining "whether a private remedy is implicit in a statute not expressly providing one . . ." *Id.* at 78. We will consider each of those factors in the discussion that follows. By way of introduction, however, we respectfully call attention to the special language of the Advisers Act. "The starting point in every case involving construction of a statute is the language itself." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring).

1. Unlike the Other Federal Securities Laws, the Investment Advisers Act Does Not Confer Jurisdiction Over "Actions at Law."

Section 214 of the Investment Advisers Act confers jurisdiction on the state and federal trial courts "of all *suits in*

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9. *See, e.g., Abrahamson v. Fleschner*, 568 F.2d 862, 872 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978); *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235, 1238 (5th Cir. 1978); *Bolger v. Laventhol, Krekstein, Horwath & Horwath*, 381 F. Supp. 260, 262 (S.D.N.Y. 1974); *Sullivan v. Chase Investment Services of Boston, Inc.*, 434 F. Supp. 171, 178 (N.D. Cal. 1977).

equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder." (emphasis added). Section 214 does *not* confer jurisdiction over "actions at law."

The distinction is significant.

The Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940 all provide that the district courts shall have jurisdiction of "all suits in equity *and actions at law* brought to enforce any liability or duty created by" those Acts. (emphasis added).[10] Comparing the Advisers Act and the Investment Company Act is particularly instructive. Both Acts were introduced at the same time, and may be regarded as companion legislation.[11] The Investment Company Act confers jurisdiction over "actions at law." The Advisers Act does not.

The history of that distinction is also significant.

The SEC's early draft of the Advisers Act simply incor-

10. *See,* Securities Act of 1933, 15 U.S.C. § 77v (1971) [May 27, 1933, c. 38, Title I, § 22, 48 Stat. 86; June 25, 1936, c. 804, 49 Stat. 1921; June 25, 1948, c. 646, § 32(b), 62 Stat. 991; May 24, 1949, c. 139, § 127, 63 Stat. 107; Aug. 10, 1954, c. 667, Title I, § 11, 68 Stat. 686; Oct. 15, 1970, Pub.L. 91-452, Title II, § 213, 84 Stat. 929]; Securities Exchange Act of 1934, 15 U.S.C. § 78aa (1971) [June 6, 1934, c. 404, § 27, 48 Stat. 902; June 25, 1936, c. 804, 49 Stat. 1921; June 25, 1948, c. 646, § 32(b), 62 Stat. 991; May 24, 1949, c. 139, § 127, 63 Stat. 107]; The Investment Company Act of 1940, 15 U.S.C. § 80a-43 (1971) [Aug. 22, 1940, c. 686, Title I, § 44, 54 Stat. 844; Dec. 14, 1970, Pub.L. 91-547, § 22, 84 Stat. 1430].

See also, the Public Utility Holding Company Act of 1935, 15 U.S.C. § 78y (1978 Supp.) [June 6, 1934, c. 404, § 25, 48 Stat. 901; June 7, 1934, c. 426, 48 Stat. 926; June 25, 1948, c. 646, § 32(a), 62 Stat. 991; May 24, 1949, c. 139, § 127, 63 Stat. 107; Aug. 28, 1958, Pub.L. 85-791, § 10, 72 Stat. 945; June 4, 1975, Pub.L. 94-29, § 20, 89 Stat. 158]; The Trust Indenture Act of 1939, 15 U.S.C. § 77vvv (1971) [May 27, 1933, c. 38, Title III, § 322, as added August 3, 1939, c. 411, 53 Stat. 1175]. The Public Utilities Holding Company Act and the Trust Indenture Act confer jurisdiction over "all suits in equity *and actions at law* brought to enforce any liability or duty created . . ." (emphasis added).

11. S. Rep. No. 91-184, 91st Cong., 1st Sess. 43-44 (1969).

porated a provision of the Investment Company Act conferring jurisdiction over "actions at law."[12] However, the final draft of the Advisers Act, approved after Senate hearings and negotiations with the SEC, did not include the jurisdiction provision of the Investment Company Act. Instead, the Advisers Act limited jurisdiction to "suits in equity."[13]

In *Abrahamson v. Fleschner,* 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978), the majority attempted to explain the omission of "actions at law" from the Advisers Act. The reason, according to the majority, is that unlike the Advisers Act, "each of the other [federal securities] Acts whose jurisdictional provisions refer to 'actions at law' contains one or more sections *expressly* granting injured parties a private right of action for damages." *Id.* at 874 (emphasis in original) (citations omitted). This required, according to the majority, a provision in each of those Acts conferring jurisdiction over "actions at law." *Id.* at 874-875.[14] The majority's explanation overlooks the fact

12. S. 3580, 76th Cong., 3d Sess., *reprinted in Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess., pt. 2, at 1 (1940); H.R. 8935, 76th Cong. 3d Sess. (1940). Section 203 of the SEC draft incorporated Section 40 of the Investment Company Act, which in turn incorporated Section 25 of the Public Utility Holding Company Act, 15 U.S.C. § 79y (1971).

13. S. 4108, 76th Cong., 3d Sess. (1940); H.R. 10065, 76th Cong., 3d Sess., *reprinted in Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce,* 76th Cong., 3d Sess. 1 (1940). Congress enacted the House bill.

14. Essentially the same explanation is offered in *Bolger v. Laventhol, Krekstein, Horwath & Horwath,* 381 F. Supp. 260, 264-265 (S.D.N.Y. 1974) and in *Sullivan v. Chase Investment Services of Boston, Inc.,* 434 F. Supp. 171, 181 (N.D. Cal. 1977). In *Wilson v. First Houston Investment Corp.,* 566 F.2d 1235 (5th Cir. 1978) the majority refers to the discussions in *Abrahamson* and *Bolger,* but does not take a position. *Id.* at 1241-1242.

that in each of the sections of the other Acts creating express civil liability, jurisdiction over "actions at law" is conferred in the *same* section.[15] The Securities Act of 1933, for example, provides that "any person acquiring such security . . . may, either at law or in equity, in any court of competent jurisdiction, sue . . ."[16] The omission of "actions at law" from the Advisers Act cannot be explained by a further explanation that those words were necessary in the jurisdiction provisions of the other federal securities acts. *Accord, Abrahamson v. Fleschner,* 568 F.2d 862, 881 n. 6 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978), (Gurfein, J., concurring and dissenting).

We do not suggest that the omission alone of "actions at law" from the Advisers Act prohibits a private right of action for damages. "The canon in favor of strict construction is not an inexorable command to override common sense and evident statutory purpose." *United States v. Brown,* 333 U.S. 18, 25 (1948). But consideration of the special language of the Advisers Act against the background of the Act's history and purpose further supports the conclusion that a private right of action at law for damages was not intended and is not necessary.

2. The Considerations Relevant to the Question of Whether the Investment Advisers Act Allows a Private Action for Damages All Suggest That No Such Right Exists.

In *Cort v. Ash,* 422 U.S. 66 (1975), this Court set forth four considerations relevant in determining whether a

15. *See,* Securities Act of 1933, 15 U.S.C. §§ 77k, 771 (1971); Securities Exchange Act of 1934, 15 U.S.C. §§ 78i(e), 78p(b), 78r (1971); Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79p(b), 79q(b) (1971); Trust Indenture Act, 15 U.S.C. § 77www(a) (1971); Investment Company Act of 1940, 15 U.S.C. § 80a-29(f) (1971).

16. 15 U.S.C. § 77k(a) (1971).

private remedy is available in a statute not expressly providing one:

> "First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted,' . . . ? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?" *Id.* at 78 (emphasis in original) (citations omitted).

Consideration of the factors set forth in *Cort v. Ash* leads to the conclusion that the Investment Advisers Act does not afford a private right of action for damages.

(a) There Is No Basis for the Conclusion That the Advisers Act Was Enacted for the Special Benefit of Investors Seeking Money Damages for Violation of the Act.

The federal courts have paid scant attention to the question of whether the Investment Advisers Act was passed for the *special* benefit of investors who retain investment advisers. The federal courts have paid even less attention to whether the Advisers Act was enacted for the special benefit of investors seeking money damages for violation of the Act.

In *Abrahamson v. Fleschner,* 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978), the majority simply concluded that the purpose of the Advisers Act was "to protect the public and investors against malpractice by persons paid for advising others about securities" and "was designed for the 'especial' benefit of persons relying upon

their investment advisers for advice." *Id.* at 873, citing S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960) and *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-191 (1963). In *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), the majority cited two Congressional reports that speak of protecting "small investors" in support of its conclusion that the plaintiff was "a member of the class of intended beneficiaries of" the Act. *Id.* at 1240. Citing the same two reports, the District Court in *Sullivan v. Chase Investment Services of Boston, Inc.*, 434 F. Supp. 171 (N.D. Cal. 1977), concluded that Congress enacted the Advisers Act "explicitly for the protection of those who employ investment advisory services." *Id.* at 181.[17]

The discussions in *Abrahamson, Wilson* and *Sullivan* demonstrate that the question of the Advisers Act's special beneficiaries is closely interwoven with the question of whether Congress intended to create a private action for damages. In *Wilson,* for example, the majority speaks of the Act's "intended" beneficiaries. *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235, 1240 (5th Cir. 1978). As will be seen, there is little or no indication Congress intended to create a private action for damages for violation of the Act. See discussion following at pages 14-21.

There can be no doubt that one basic purpose of the Advisers Act is to protect investors who retain investment advisers. There is ample authority to support that conclu-

17. In *Bolger v. Laventhol, Krekstein, Horwath & Horwath*, 381 F. Supp. 260 (S.D.N.Y. 1974), the only other reported decision which fully considers whether the Advisers Act affords a private action for damages, the District Court had no occasion to consider whether the Act was adopted for the special benefit of the plaintiffs in that case. *Cort v. Ash*, 422 U.S. 66 (1975), and the considerations it prescribes, were not announced until a year later.

sion.[18] But there is a distinction between a statute's goals and the means chosen to reach those goals. A conclusion that the purpose of the Advisers Act is to protect investors who use investment advisers does not, without more, endow those investors with the right to sue for money damages in the federal courts. Congress "may intend a statute to protect investors—but not necessarily without limit." *Abrahamson v. Fleschner,* 568 F.2d 862, 882 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978) (Gurfein, J., concurring and dissenting). The purpose of the Advisers Act may well be satisfied *even though* the Act does not afford a private action for money damages.[19]

To conclude that the Advisers Act is intended to protect investors who retain investment advisers does not mean that a plaintiff seeking money damages is "one of the class for whose 'especial' benefit the statute was enacted." *Cort v. Ash,* 422 U.S. 66, 78 (1975). The Act's intent may well be satisfied by its disclosure requirements and SEC enforcement. The language of the Advisers Act suggests that Congress has come to that conclusion. See discussion above at pages 7-10.

18. *See, e.g.*, H.R. Rep. No. 2639, 76th Cong., 3d Sess. 28 (1940); S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940); S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960).

19. The first reported case involving a private claim for damages under the Advisers Act appears to be *Brouk v. Managed Funds, Inc.*, 286 F.2d 901 (8th Cir. 1961), *vacated as moot*, 369 U.S. 424 (1962), where the issue here was presented but not decided. The next reported case involving a private claim for damages under the Act appears to be *Schlusselberg v. Werly,* [1966-1967 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,012, 96,436 (S.D. N.Y. 1967). *Schlusselberg,* like several cases that followed, granted relief on other grounds, principally the Securities Exchange Act of 1934. Not until 1974 do we find discussion of whether the Advisers Act permits a private action for damages. *See, Gammage v. Roberts, Scott & Co.*, [1974-1975 Transfer Binder] CCH Fed.Sec. L.Rep. ¶ 94,761, 96,503, (S.D. Cal. 1974); *Greenspan v. Del Toro,* [1975-1976 Transfer Binder] CCH Fed.Sec.L.Rep., ¶ 95,488, 99,459 (S.D. Fla. 1974).

The majority opinions in *Abrahamson* and *Wilson* and the District Court's opinion in *Sullivan* pay ample attention to the basic purposes of the Advisers Act, but little or no attention to whether investors seeking money damages for alleged violations of the Act were intended to be among its special beneficiaries.

That the Act was intended to protect investors using investment advisers does not mean that the Act opened the federal courts to actions for money damages by disgruntled clients of investment advisers. The basic purposes of the Act may well be satisfied by a variety of remedies already available. For example, if the respondent here were able to allege intentional misrepresentation in connection with his purchase of stock in Mortgage Trust of America, he would have access to the federal courts under Section 10(b) of the Securities Exchange Act of 1934.[20]

There is little reason to conclude that the Investment Advisers Act was passed for the special benefit of investors seeking money damages for violation of the Act. Further analysis leads the other way.

(b) There Is No Clear Indication That Congress Intended to Create a Private Action for Money Damages for Violation of the Investment Advisers Act.

The second factor to be considered in determining whether the Advisers Act provides a right of action for money damages is legislative intent. *Cort v. Ash*, 422 U.S. 66, 78 (1975). Here, the evidence of legislative intent can lead to only one conclusion: the Investment Advisers Act does not provide a private right of action for money damages.

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20. *See*, 15 U.S.C. § 78j(b) (1971); *and see, Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

When the Advisers Act was introduced in 1940, the SEC's chief counsel testified that the Act's "basic approach" was to obtain "a compulsory census." *Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76 Cong., 3d Sess. 48.

> "We first would like to find out how many people are engaged in this business, what their connections are, what is the extent of their authority, what is their background, who they are, and how they handle the people's funds." *Id.*

There is no indication that the SEC regarded a private right of action for money damages as even relevant to its "compulsory census." Nor do we find any indication that Congress considered a private damage action an appropriate part of the Advisers Act.

Quite the opposite is true.

The SEC's initial draft of the Advisers Act incorporated a provision of the Investment Company Act conferring jurisdiction over "all suits in equity and *actions at law*."[21] Following hearings in the Senate, industry representatives met with the SEC and negotiated numerous changes.[22] The changes included the addition of a separate

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21. *See*, S. 3580, 76th Cong., 3d Sess., *reprinted in Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. § 203 (1940). Section 203 incorporated Section 40 of the proposed Investment Company Act, which in turn incorporated Section 25 of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79y (1971). See discussion above at pages 8-9.

22. *See, Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 72, 95 (1940); 76 Cong. Rec. 10069 (1940) (remarks of Senator Wagner). A spokesman for the investment industry, recognizing that he was "not a disinterested commentator," has written a detailed account of the enactment of the Investment Company Act and Investment Advisers Act. *See*, Jaretski, *The Investment Company Act of 1940*, 26 Wash.L.Q. 303 (1941).

jurisdiction provision. The provision refers to "suits in equity" but *omits* reference to "actions at law." S. 4108, 76th Cong., 3d Sess. (1940); H.R. 10065, 76th Cong., 3d Sess., *reprinted in Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce,* 76th Cong., 3d Sess. 1 (1940).

There are various indications that the Advisers Act, as enacted, was a compromise between the SEC and the investment advisory industry.[23] Among the changes, the deletion of "actions at law" from the original draft of the Act is important. It was the only change directly relevant to the issue here. The original draft referred to jurisdiction over "actions at law." The final draft did not. "There is," Mr. Justice Swayne once said, "no surer way to find out what parties meant, than to see what they have done." *Brooklyn Life Insurance Co. v. Dutcher*, 95 U.S. 269, 273 (1877).

There is another important omission from the Advisers Act, which is further indication that Congress never intended to create a private action for money damages. Unlike the other federal securities acts, the Advisers Act does not provide *any* express civil liability in damages. We agree with Judge Gurfein that this omission is "highly relevant."

> "[I]n *each* of the other Acts Congress itself did provide for some *express* civil liability, yet under the Advisers Act it failed to include a single section imposing liability for damages. Congress, for example, could have provided an express damage remedy for misrepresentations in the registration statement of the advisers as it did for misrepresentations of the registration statement of the underwriter, 15 U.S.C. § 77k (a)(5). This indicates rather that, in its cautious approach to the regulation of investment advisers, Congress was not yet ready to impose *any* civil liability for damages." *Abrahamson v. Fleschner*, 568 F.2d 862, 881 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978) (Gurfein, J., concurring and dissenting) (emphasis in original).

23. *Accord*, Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 Mich.L.Rev. 308, 319-320, n.69 (1975).

The majority in *Wilson* conceded that Judge Gurfein's explanation was "plausible" but concluded that the legislative history of the Advisers Act offers "no substantial assistance . . . with respect to Congress' intentions." *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235, 1242 (5th Cir. 1978). That conclusion appears to ignore the legislative history of the Act—legislative history which belies argument that the Advisers Act authorizes private actions for money damages.

1960 Legislation—Between 1956 and 1959, the SEC submitted numerous proposals to Congress relating to the federal securities laws, including amendments to the Investment Advisers Act. S. Rep. No. 1760, 86th Cong., 2d Sess. 2 (1960). None of the proposed amendments added to the Act's limited grant of jurisdiction over "suits in equity" set forth in Section 214.[24] Nor did any of the 19 changes to 11 of the Act's 21 sections approved by Congress in 1960 alter Section 214.

The 1960 amendments strengthened the enforcement powers of the SEC.[25] It empowered the Commission to deny,

24. The SEC was apparently aware of the issue here as early as 1957. In *Hull v. Newman, Kennedy & Co.*, U.S.D.C., S.D.N.Y., 57 Civ. 118-283 (settled), referred to at 24 SEC Ann. Rep. 162 (1959), the SEC filed an *amicus* brief supporting the recognition of private actions to enforce the Advisers Act.

25. "A major concern of the [amendments] is to aid the *Commission* in enforcing compliance with the act." S.Rep.No. 1760, 86th

delay or cancel an individual's registration as an investment adviser if the adviser failed to meet tightened registration qualifications. Pub.L. No. 86-750, §§ 2, 3, 4 & 5, 74 Stat. 885, *amending* § 203 of the Act, 15 U.S.C. § 80b-3 (1971). It empowered the SEC to promulgate rules requiring advisers to keep certain books and records and to make those books and records available for inspection by the Commission. Pub.L. No. 86-750, § 6, 74 Stat. 885, *amending* § 204 of the Act, 15 U.S.C. § 80b-4 (1971). It extended the antifraud provisions of Section 206 to all investment advisers, whether or not registered with the Commission. Pub.L. No. 86-750, § 8, 74 Stat. 885, *amending* § 206 of the Act, 15 U.S.C. § 80b-6 (1971). Section 209, entitled "Enforcement of Title," was amended to allow the *Commission* to obtain an *injunction* against aiders and abettors as well as principal violators. Pub.L. No. 86-750, § 12, 74 Stat. 885. No provision was made for actions at law against aiders and abettors—an omission indicating a deliberate decision by Congress to ensure that no private action for money damages would be implied as was implied under Section 10(b) of the 1934 Act.

Congress considered enforcement of the Advisers Act in 1960, and came to the conclusion that the SEC was in the best position to enforce its limited provisions. Respondents would have this Court disregard that conclusion and create a remedy where none exists.

1970 Legislation—In 1970 Congress amended the Investment Company Act and the Advisers Act. The amendments included the addition of a private right of action against

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Cong., 2d Sess. 4 (1960) (emphasis added). The Senate Report further explains that, unlike the other federal securities statutes, the Advisers Act has few substantive or regulatory provisions, and, like the broker-dealer registration provisions of the 1934 Act, "resembles a continuing census of the Nation's investment advisers." *Id.* at 2.

certain investment advisers under the Investment Company Act, but *no* additional remedies under the Advisers Act. Public Law No. 91-547, 84 Stat. 1413, *adding* § 36(b) of the Investment Company Act, 15 U.S.C. § 80a-35(b) (1971). Having considered the liability of investment advisers and having made no provision under the Advisers Act for their liability in money damages, Congress almost certainly intended that no such remedy exist, a conclusion supported by its description of the Act's limited objectives.

> "The Investment Advisers Act of 1940 is a companion statute to the Investment Company Act. It regulates the activities of those who receive compensation for advising others with respect to investments in securities or who are in the business of issuing analyses or reports concerning securities. Like other Federal securities statutes, the Advisers Act prohibits fraudulent practices and requires those subject to its provisions to register with the Commission and to keep books and records in accordance with Commission rules. It also empowers the Commission to make regular inspections and to take administrative remedial action against applicants for registration and registered advisers." S. Rep. No. 91-184, 91st Cong., 1st Sess. 43-44 (1969).

The statements and actions of Congress attending the 1970 amendments to the Investment Company Act and Advisers Act offer no support for the respondent here.

1976 Legislation—In 1976 an amendment to the Advisers Act expressly conferring jurisdiction over "all suits in equity *and actions at law*" was introduced by the SEC. S. 2849, 94th Cong., 2d Sess. § 6 (1976) (emphasis added); *and see*, [1975-1976 Transfer Binder] CCH Fed. Sec.L.Rep. ¶ 80,341, 85,895 (SEC Investment Advisers Act Release No. 491, December 15, 1975). The bill was reported out of a

Senate committee,[26] but did not come to a vote. Professor Loss testified that the amendment would not create a private action for damages, but would simply facilitate its implication by the courts.[27] Professor Loss's explanation may be open to question. One does not think of an act of Congress as a garden for implications. But the tacit admission in the proposed amendment is apparent: the Advisers Act does *not* provide a private right of action for money damages.

1977 Legislation—The 1976 amendments were reintroduced in January, 1977. Again, the amendments explicitly provided that the federal district courts would have jurisdiction of "all suits in equity and *actions at law.*" H.R. 2105, 95th Cong., 1st Sess. § 7 (1977) (emphasis added). There have been no hearings on the bill. The SEC has apparently decided not to pursue enactment, but has stated that it might consider instead studies of investment advisers as "an alternative to legislation at this time."[28]

Legislative history can be ambiguous, and we are not unmindful of the limits inherent in "mute intermediate legislative maneuvers."[29] But we are aware of no clear evidence of Congressional intent to create a private action for money damages under the Advisers Act.

In *National Railroad Passenger Corp. v. National Ass'n of Railroad Passengers,* 414 U.S. 453 (1974) (*"Amtrak"*) this Court held that where a statute provides a particular

26. *See,* S. Rep. No. 910, 94th Cong., 2d Sess. (1976).

27. *Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs,* 94th Cong., 2d Sess. 232-233 (1976).

28. *See,* BNA, Sec.Reg. & L.Rep., No. 392, at A-12 (March 2, 1977).

29. *Trailmobile Co. v. Whirls,* 331 U.S. 40, 61 (1947).

remedy, other means of enforcement are precluded. *Id.* at 458. The holding in *Amtrak* was followed in *Securities Investor Protection Corp. v. Barbour,* 421 U.S. 412 (1975), where this Court, quoting *Amtrak,* ruled that the inclusion of an alternate remedy could only be based on "clear . . . evidence of legislative intent." *Id.* at 419.

No such evidence exists.

Here, the only conclusions one may reasonably draw from the legislative history of the Advisers Act are that (1) Congress intended to survey and monitor investment advisers and (2) Congress assigned that task to the SEC. There is little or no evidence, let alone "clear" evidence, that Congress intended to enforce the Advisers Act by creating a private right of action for money damages. There is no evidence, let alone "clear" evidence, that Congress intended to open the federal courts to every disgruntled client of every investment adviser.

(c) Implying a Private Action for Damages Under the Advisers Act Is Not Necessary to Fulfill the Main Purposes of the Act.

The main or "underlying purposes" of the Investment Advisers Act is the third factor to be considered in determining whether the Act provides a private action for damages. *Cort v. Ash,* 422 U.S. 66, 78 (1975).

The main purposes of the Advisers Act are an aspect of Congressional intent. The second and third factors described in *Cort v. Ash* are closely related. For example, in *Wilson v. First Houston Investment Corp.,* 566 F.2d 1235 (5th Cir. 1978) the majority concluded that "Congress sought to protect investors" by regulating the investment advisory industry. *Id.* at 1242. That conclusion is then relied upon for the further conclusion that "a private right

of action for damages . . . is consistent with the remedial purposes contemplated by Congress." *Id.*[30]

Here, the evidence relevant to Congressional intent leads away from any conclusion that the Advisers Act provides a private right of action for money damages. See discussion above at pages 14-21. In Judge Gurfein's words, "Whatever evidence exists looks the other way." *Abrahamson v. Fleschner,* 568 F.2d 862, 883 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978) (Gurfein, J., concurring and dissenting). To the extent that the main purposes of the Advisers Act are an aspect of Congressional intent, there is little basis for an argument that the Act provides a private right of action for money damages.

Separating the stated purposes of the Advisers Act from conclusions about Congressional intent leads to the same conclusion, namely, that the purposes of the Act can be met without implying a private right of action for damages.

(1) The "basic approach" of the Advisers Act according to the SEC was to effect a "compulsory census" and the registration of investment advisers with the SEC. *Hearings on S. 3580 Before the Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 48 (1940).[31] Allowing a private investor to seek money damages in the federal courts from an investment adviser that had failed

30. In *Sullivan v. Chase Investment Services of Boston, Inc.*, 434 F.Supp. 171 (N.D. Cal. 1977), the District Court discussed the Act's main purposes at length. *Id.* at 182-183. But the discussion is largely dependent on a previous discussion of legislative intent. The District Court states, for example, that "[a]s previously discussed, the primary purpose of the Investment Advisers Act was to protect the investing public." *Id.* at 183.

31. The census-taking and registration features of the Advisers Act were repeatedly emphasized in the Senate Hearings. *See, e.g., Hearings on S. 3580 Before the Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 51, 319 (1940).

to register would seem to be unnecessary and ill-advised—even apart from the always difficult questions of reliance and causation.

(2) Another announced purpose of the Advisers Act is to protect investment advisers from the adverse effects of disclosure that the adviser is being investigated by the SEC.

> "In order to safeguard against this danger section 210(a) and (b) [15 U.S.C. § 80b-10] provide that there shall not be any disclosure of any investigation by the Securities and Exchange Commission until it has made up its mind that a public hearing is to be held. Then in order to safeguard them further, subsection (c), provides that the Commission cannot ask these investment counsellors to disclose their clients, and what their investments are, except if there is some indication of wrongdoing. Thereafter . . . they have to make the disclosure." *Hearings on H.R. 10065 Before the Subcomm. of the House Comm. on Interstate and Foreign Commerce,* 76th Cong., 3d Sess. 138 (1940).

The argument that the Advisers Act provides a private right of action for damages ignores the protection embodied in Section 210 of the Act, a provision which protects investment advisers during an SEC investigation. Section 210 "belies any intention by Congress to open wide private civil complaints which, in the nature of our adversary proceedings, become public property at once." *Abrahamson v. Fleschner,* 568 F.2d 862, 886 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978) (Gurfein, J., concurring and dissenting).

(3) Assuming a main purpose of the Advisers Act is to protect the public and investors from unscrupulous or negligent investment advisers,[32] it does *not* follow that the Act

32. *See, e.g., Abrahamson v. Fleschner,* 568 F.2d 862, 873 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978); *Wilson v. First Houston Investment Corp.,* 566 F.2d 1235, 1242 (5th Cir. 1978); *Bolger v. Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260, 263 (S.D.N.Y. 1974).

authorizes a private right of action of any kind. As discussed above, there is an important distinction between a statute's goals and the means chosen to reach those goals. See discussion above at pages 11-14. There are various indications—the special language, a cautious approach, the Act's legislative history—that Congress deemed the registration and disclosure provisions of the Advisers Act adequate for the Act's main purposes.[33]

(4) Even if one assumed for argument that a private action for damages is consistent with the underlying purposes of the Advisers Act, there is no evidence to suggest that a private damage action is *necessary*. A private damage action may well be consistent with the general purposes of a statute, but is not necessary to reach the statute's objectives.

The distinction is important.

In *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), this Court considered whether a private right of action for damages was *necessary* to enforce the Williams Act of 1968, 15 U.S.C. § 78n(e) (1971). The opinion suggests that once a court has identified the legislative purpose, it must determine whether "the creation by judicial interpretation of [an] implied cause of action . . . is *necessary* to effectuate Congress' goals." *Piper v. Chris-Craft Industries, Inc., supra* at 24-26 (emphasis added).

Here, a private action for money damages is by no means *necessary* to protect the public and investors from unscrupulous or negligent investment advisers. That objective is reached through a variety of powers and remedies already available to the SEC. *See, e.g.*, 15 U.S.C. § 80b-3(e) (1971) (denial or revocation of registration); 15 U.S.C. § 80b-4

33. *Accord*, Note, *Securities Law—Investment Adviser Fraud —A Private Damages Remedy Is Implied Under Section 206 of the Investment Advisers Act of 1940*, 30 Vand.L.Rev. 905, 919 (1977).

(1971) (examination of records); 15 U.S.C. § 80b-9(e) (1971) (authority to enforce compliance). The Advisers Act is limited legislation aimed at a small facet of the financial community. A private action for money damages under the Advisers Act is no more *necessary* than a private right of action in favor of broker-dealer customers under the Security Investor Protection Act,[34] tender offerors under the Williams Act,[35] train passengers under the Rail Passenger Act of 1970;[36] or investors of a corporation alleged to have made political contributions in violation of the Federal Election Campaign Act.[37]

(d) Actions for Misrepresentation or Nondisclosure and Actions for Breach of Fiduciary Duty Are a Mainstay of State Court Litigation.

The final factor to be considered in determining whether a private right of action may be implied from a statute not expressly providing one is whether the cause of action alleged is "traditionally relegated to state law, in an area basically the concern of the States, . . ." *Cort v. Ash*, 422 U.S. 66, 78 (1975).

Here, respondent Harry Lewis has alleged six claims for relief. The first three are derivative and the last three purport to be class actions on behalf of the shareholders of Mortgage Trust of America. The first (derivative) and fourth (class) allege that TAMA and Transamerica Corporation failed to register as required by the Investment Advisers Act, and that certain fees paid to TAMA by the

34. *See, Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412 (1975).

35. *See, Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977).

36. *See, National Railroad Passenger Corp. v. National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("*Amtrak*").

37. *See, Cort v. Ash*, 422 U.S. 66 (1975).

Trust were excessive. The second (derivative) and fifth (class) claims allege unfairness and conflicts of interest in the Trust's purchase of its initial loan portfolio. The third (derivative) and sixth (class) claims allege breach of fiduciary duty and breach of trust by TAMA and Transamerica Corporation in rendering investment advice to Mortgage Trust of America. (A. 3-21).

None of respondent's allegations are foreign to state practice. On the contrary, allegations of misrepresentation, willful concealment of material facts, and breach of fiduciary duty are a mainstay of state court litigation. *See, e.g.*, 37 C.J.S. *Fraud* §§ 1-3 (1943); Prosser, *Law of Torts* §§ 105-106, 683-694 (4th ed. 1971); 4 Witkin, *Summary of California Law*, §§ 445-446, 2710-2711 (8th ed. 1974).

Actions by beneficiaries against trustees for breach of fiduciary duty are especially familiar to the state courts. Included with this brief at *Addendum C* is a selection of reported cases in New York and California since 1940 in which it was alleged that one or more trustees breached a fiduciary duty owed to a trust and its beneficiaries. The discussions in numerous authorities further attest to the fact that claims of the type made by Harry Lewis in this case are a staple feature of state court litigation. *See, e.g.*, 76 Am. Jur. 2d *Trusts* §§ 315-323, 534-544 (1975); Restatement of Trusts § 170 (Appendix) (1959); II Scott, *The Law of Trusts* § 170, 1297-1299 (1967).

In *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978) the majority suggests that implying a private right of action for money damages under the Advisers Act would overcome the obstacles to recovery in a common law action for fraud. *Id.* at 1242. The majority opinion assumes that the Advisers Act eases an investor's proof of wrongdoing by an investment adviser—an assumption that begs the question. The majority in *Wilson* also overlooks the familiar rule that an investment adviser owes his or her client a fiduciary duty.[38] The existence of that duty alone eases the burden of proving common law deceit.[39] The Advisers Act is irrelevant to the burden of proof.

That the Advisers Act is aimed at regulation of investment advisers on a national scale[40] does not mean the Act created a *private* federal right of action. That Congress has passed legislation regulating tender offers on a national scale does not mean that offerors enjoy a private right of action under the Williams Act for money damages. *See, Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977). Again, there is a distinction between intention and means, objectives and method.

Finally, it has been suggested that since only 27 states have anti-fraud statutes regulating investment advisers, with only one statute providing a private remedy, implication of a private action for damages under the Advisers Act would be appropriate. *See, Sullivan v. Chase Investment Services of Boston, Inc.*, 434 F.Supp. 171, 184 (N.D. Cal. 1977).[41] The suggestion appears to ignore remedies readily available at common law, and what may well be an advan-

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38. *See, e.g., Twomey v. Mitchum, Jones & Templeton, Inc.*, 262 Cal.App.2d 690, 69 Cal.Rptr. 222 (1968); *Walsh v. Hooker & Fay*, 212 Cal.App.2d 450, 28 Cal.Rptr. 16 (1963); *Walston & Co. v. Miller*, 100 Ariz. 48, 410 P.2d 658 (1966). *See also, Galfand v. Chestnutt Corp.*, 545 F.2d 807 (2d Cir. 1976); *Rosenfeld v. Black*, 445 F.2d 1337 (2d Cir. 1971).

39. *See*, 37 C.J.S. *Fraud* § 95, 401 (1943); 34 Cal.Jur.3d *Fraud and Deceit* § 79, 722-726 (1977). *See also, Solon v. Lichtenstein*, 39 Cal.2d 75, 244 P.2d 907 (1952); *Moe v. Transamerica Title Ins. Co.*, 21 Cal.App.3d 289, 98 Cal.Rptr. 547 (1971).

40. *See*, S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).

41. The state statutes regulating investment advisers are collected at Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 Mich.L. Rev. 308, 324, n. 103 (1975).

tage at common law to the investor plaintiff alleging fraud. See discussion above at pages 26-27. If indeed the purpose of the Advisers Act is "to protect the public and investors against malpractice by persons paid for advising others about securities."[42] the common law offers a formidable arsenal of precedents, presumptions and remedies.

3. Implying a Private Right of Action for Damages Under the Advisers Act Would Destroy the Limitations on Private Actions by Investors Recently Recognized by This Court.

In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) this Court recognized an important limitation on actions by investors under the Section 10(b) of the Securities Exchange Act of 1934.[43] In *Blue Chip Stamps*, it was held that unless the investor plaintiff could establish that the alleged wrongdoing was committed in connection with the purchase or sale of a security, the investor could not maintain a private action for money damages under Section 10(b) and Rule 10b-5. *Id.* at 749. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) the Court stated another important limitation on Section 10(b) actions and held that a private action for damages would not lie under Section 10(b) and Rule 10b-5 absent an allegation by the investor that the defendant intended to defraud, deceive or manipulate. *Id.* at 193.

These two important limitations stand astride the Investment Advisors Act, and are among the more important practical reasons why the Act should not afford investors a right of action for money damages. Simply stated, the

42. *Abrahamson v. Fleschner*, 568 F.2d 862, 873 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), quoting S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960).

43. 15 U.S.C. § 78j(b) (1971).

majorities in *Abrahamson*,[44] *Wilson*[45] and the court below[46] have authorized securities litigation in the federal courts without boundaries. The majorities in *Abrahamson*, *Wilson* and the court below have undermined well-reasoned limitations on access to the federal courts by investors in securities.

Section 206 of the Advisers Act, set forth at *Addendum A*, declares unlawful certain actions by investment advisers without regard to whether those actions are "in connection with the purchase or sale of any security . . ."[47] This would open the federal courts, as it did in *Abrahamson*, to claims by investors who could only allege that they had been induced *not* to sell certain securities.[48] As Judge Gurfein explained in dissent, the majority "holds that the 10b-5 claim is without merit, yet on the *same* factual allegations . . . supports a § 206 claim."[49] Implying a private right of action under the Advisers Act "circumvents the sound policies behind restrictions on 10b-5 claims."[50]

The majority in *Abrahamson* considered the purchaser-seller requirement of Section 10(b) and explained that it "was based on the *express language* of Section 10(b) and

44. *Abrahamson v. Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978).

45. *Wilson v. First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978).

46. *Lewis v. Transamerica Corp.*, 575 F.2d 237 (9th Cir. 1978) *cert. granted*, ... U.S. ....., 99 S. Ct. 348 (1978). (A. 28-32).

47. *Compare* 15 U.S.C. § 78j(b) (1971) (Section 10(b) of the Securities Exchange Act of 1934) *with* 15 U.S.C. § 80b-6 (1971) (Section 206 of the Investment Advisers Act of 1940).

48. *Abrahamson v. Fleschner*, 568 F.2d 862, 868 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978).

49. *Id.* at 884 (Gurfein, J., concurring and dissenting) (emphasis in original).

50. *Id.*

Rule 10b-5 requiring a fraud 'in connection with the purchase or sale of any security.' "[51] No such requirement appears in Section 206 of the Advisers Act, and the majority concluded that the purchaser-seller requirement was regarded by this Court as applicable only to 10b-5 actions.[52]

In dissent Judge Gurfein speculated that the concern underlying the purchaser-seller requirement "is the sheer inability to disprove what a plaintiff says he *would have* done if he had but known the truth."[53]

> "There is a distinct danger that, by implying an open-ended private right of action, the court is giving the clients of investment advisers *carte blanche* to convert themselves from victims to defrauders." *Abrahamson v. Fleschner*, 568 F.2d 862, 884 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978) (Gurfein, J., concurring and dissenting).

Judge Gurfein's remarks are pertinent here.

Of the 15 Adviser Act suits against advisers to real estate investment trusts known to petitioners, 11 appear to have been settled or withdrawn.[54] It seems reasonable to assume

51. *Id.* at 877.

52. *Id.*

53. *Id.* at 884 (Gurfein, J., concurring and dissenting) (emphasis in original).

54. *Lewis v. Transamerica Corp.*, 575 F.2d 237 (9th Cir. 1978), *cert. granted*, ... U.S. ....., 99 S. Ct. 348 (1978); *Kusner v. First Pennsylvania Corp.*, 531 F.2d 1234 (3d Cir. 1976) and 74 F.R.D. 606 (E.D. Pa. 1977) (settled); *Jones v. Equitable Life Assurance Society*, CCH Fed. Sec. L. Rep. ¶ 94,986, 97,402 (S.D. N.Y. 1975) (settled); *Coper v. USF Investors*, U.S.D.C., S.D.N.Y., 73 Civ-2769-MP (settled); *Greenspan v. First Mortgage Investors*, U.S.D.C., S.D. Fla., 73-638-Civ-JE (dismissed); *Kramer v. Massachusetts Mutual Mortgage & Realty Investors*, U.S.D.C., S.D.N.Y., 73 Civ-1306 (settled); *Kreindler v. Citizens Mortgage Investment Trust*, U.S.D.C., S.D.N.Y., 73 Civ-1623 (settled); *Lerman v. ATICO Advisory Corp.*, U.S.D.C., S.D. Fla., 73-1172-Civ-JE, *dismissed on motion of the appellee*, 5th Cir., 74-2751 (unpublished); *Schreiber v. Northwestern Mutual Life Mortgage Realty Investors*, U.S.D.C., E.D. Wisc., 73 Civ. 1056 (withdrawn); *Uttrich v. Lomas & Nettleton Mortgage Investors*, U.S.D.C., D. Conn., Civ-15704 (withdrawn); *Greenspan v. Continental Mortgage Investors*, U.S.D.C., D. Mass., 72-1160-T (settled); *Mayer v. Chase Manhattan Mortgage and Realty Trust*, U.S.D.C., S.D.N.Y., 72 Civ-1623 (settled); *Mayer v. Wilson*, U.S.D.C., D. Conn., Civ. 76-1740-F (pending).

The respondent here, Harry Lewis, is the plaintiff in two other suits against advisers to real estate investment trusts. *See, Lewis v. Diversified Mortgage Investors*, U.S.D.C., S.D.N.Y., 75 Civ-1001 (settlement pending); *Lewis v. Guardian Mortgage Investors*, U.S. D.C., M.D. Fla., 73-851-Civ.JT (settled).

that one of the reasons for settlement may have been the recognition by the advisers and their counsel of the "sheer inability to disprove what a plaintiff says he *would have* done." This Court has recognized that investor claims often have settlement value out of all proportion to their inherent merit. See, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740-742 (1975).

The majorities in *Abrahamson, Wilson* and the court below have created what Judge Gurfein called "an analogue to Section 10(b)" without limits.

> "To create an analogue to Section 10(b) without the requirement that the 'fraud' be 'in connection with the purchase or sale' of a security hardly gives broad effect to the policy considerations so clearly expressed in the majority opinion of the Supreme Court in *Blue Chip Stamps* . . . The majority specifies no limits to the civil liability under § 206 . . . Yet, it is simply extending 10b-5 by resort to a different statute." *Abrahamson v. Fleschner*, 568 F.2d 862, 885 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978) (Gurfein, J., concurring and dissenting).

The "purchaser-seller" limitation of Section 10(b) of the Securities Exchange Act is only one of several considerations relevant to determining the real-life effect of implying a private right of action under the Advisers Act. We do not know, for example, whether advice *negligently* given could

be the basis for a damage action by an investor.[55] The language of Section 206 of the Advisers Act suggests a requirement that the investor plaintiff plead and prove scienter. But prior to *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), analogous language in Section 10(b) of the Securities Exchange Act did not prevent the lower courts from approving allegations of negligence.[56]

Implying a private right of action for money damages under the Advisers Act may be seen as an invitation to litigation—litigation to test the Act's meaning, application and outer limits. Even those commentators sympathetic to an implied right of action under the Advisers Act recognize the difficulties the federal courts would face in attempting to define and limit that right.[57] It may be sufficient to note that the majorities in *Abrahamson, Wilson* and the court below have created a private action for money damages based on language intended to guide equitable enforcement by the SEC.

CONCLUSION

There are good and substantial reasons why this Court should not approve a private action for money damages under the Investment Advisers Act.

The special language of the Act, the indications of Congressional intent, the alternate remedies available at common law, and the practical difficulties that would follow all support a conclusion that a private action for damages

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55. *See generally, Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

56. *See, e.g., White v. Abrams*, 495 F.2d 724, 730 (9th Cir. 1974); *Myzel v. Fields*, 386 F.2d 718, 735 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Kohler v. Kohler Co.*, 319 F.2d 634, 637 (7th Cir. 1963).

57. *See*, Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 Mich. L. Rev. 308, 331-338 (1975).

under the Advisers Act was not intended, is not necessary, and would be unwise.

We respectfully pray an order of this Court *reversing* the decision of the court below.

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January 2, 1979

Addendum A

Section 206, Investment Advisers Act of 1940; 54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6:

§ 80b-6. Prohibited transactions by investment advisers.

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Aug. 22, 1940, c. 686, Title II, § 206, 54 Stat. 852; Sept. 13, 1960, Pub.L. 86-750, §§ 8, 9, 74 Stat. 887.

Addendum B

Section 214, Investment Advisers Act of 1940; 54 Stat. 856, 15 U.S.C. § 80b-14:

§ 80b-14. Jurisdiction of offenses and suits.

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court.

Aug. 22, 1940, c. 686, Title II, § 214, 54 Stat. 856.

Addendum C

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; and MORTGAGE TRUST OF AMERICA,

Petitioners,

—v.—

HARRY LEWIS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENT

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In the

Supreme Court of the United States

October Term, 1977

No. 77-1645

Transamerica Mortgage Advisors, Inc. (TAMA); Kent L. Colwell; J. Wendell Coombs; John R. Jensen; Ralph D. Wenger; John Havens; Transamerica Corporation; Transamerica Land Capital, Inc.; and Mortgage Trust of America,

Petitioners,

—v.—

Harry Lewis,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENT

Opinions Below

The opinion of the District Court, incorporated in its order (A. 24-25),[1] and a further order of that Court dismissing the action (A. 26-27), are unreported.

The opinion of the Court of Appeals for the Ninth Circuit (A. 28) is reported at 575 F.2d 237 (9th Cir. 1978).

The majority opinion of the Court of Appeals holds simply that a private right of action for injunctive relief and damages may properly be implied under Section 206 of

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[1] All "A. ....." references are to the Single Appendix.

the Investment Advisers Act of 1940, resting upon the reasoning in the majority opinions in *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), and *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), *petition for cert. docketed*, No. 77-1717. The dissenting opinion adopts the dissent in *Abrahamson* v. *Fleschner*, 568 F.2d at 879.

Jurisdiction

The jurisdictional requisites are adequately set forth in *Brief for Petitioners* at 2.

Question Presented

May a private right of action be implied under the Investment Advisers Act of 1940?

Statutes

The pertinent provisions of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1, *et seq.*, are Sections 206,[2] 214[3] and 215(b),[4] which are set forth in the Addendum to this Brief.

Statement of the Case

This action was begun by respondent, as a shareholder of MTA, suing derivatively on behalf of MTA and representatively on behalf of its shareholders, in April 1973, in

[2] Aug. 22, 1940, c.686, Title II, § 206, 54 Stat. 852; Sept. 13, 1960, Pub. L. 86-750, §§ 8, 9, 74 Stat. 887.

[3] Aug. 22, 1940, c.686, Title II, § 214, 54 Stat. 856.

[4] Aug. 22, 1940, c.686, Title II, § 215, 54 Stat. 856.

the United States District Court for the Southern District of New York.

The complaint alleges, *inter alia*, violations of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6, arising out of the making and performance of the investment advisory agreement between petitioners Mortgage Trust of America ("MTA") and Transamerica Mortgage Advisors, Inc. ("TAMA"). (A. 3.)

MTA is a real estate investment trust, organized and operated so as to qualify as such under Sections 856-858 of the Internal Revenue Code of 1954, as amended, 26 U.S.C. §§ 856-858 (1970). Shortly after its organization in 1969, it issued to the public more than 3,168,000 shares of beneficial interest. (A. 4, 5.) MTA was established to invest in a diversified portfolio of real estate mortgages of various types, other real estate loans and some equity interests in real estate; and has transacted business throughout the United States. (*Id.*)

TAMA was, since June 1969, the investment adviser to MTA, pursuant to an advisory agreement first made at or about the time of MTA's organization. (A. 8.) It advises MTA with respect to MTA's investment portfolio and also administers its day-to-day operations. (*Id.*) TAMA, a third-tier subsidiary of petitioner Transamerica Corporation ("Transamerica"), has been MTA's only investment adviser; and MTA has been TAMA's only client. (A. 28.)

Petitioner Transamerica was the parent of TAMA and the sponsor of MTA, and the parent of Transamerica Land Capital, Inc. ("TALC"). MTA acquired about half of its initial investment portfolio from TALC (A. 14), as well as its original officers and employees.

The named individual defendants in the action, including the individual petitioners, were the trustees of MTA;

several of whom, including petitioners Colwell, Coombs, Jensen and Wenger, had at the same time been affiliated as officers with Transamerica, TAMA or other Transamerica subsidiaries. (A. 9.)

The complaint asserted six causes of action; the first three being derivative claims on behalf of MTA, and the latter three being restatements of the former, cast in representative form. (A. 3 *et seq.*)

The first cause of action asserts that fraudulent conduct and practices permeated the making and performance of the advisory agreement between MTA and TAMA; and sought avoidance of that contract or any renewal or extension thereof, as well as restitution of compensation paid thereunder, and consequential damages. (A. 4-14, 20.) Because Transamerica controlled and dominated MTA and TAMA, and exercised that domination with respect to both the formation and performance of the advisory relationship, the complaint charged, MTA was caused to enter into a contract of adhesion with TAMA, the very design of which required that unwarranted, unlawful and grossly excessive fees would be paid by MTA. The making and performance of the advisory contract, as well as the extraction of grossly excessive fees thereunder, are alleged to violate Section 206 of the Investment Advisers Act. (A 10-12.)

The second cause of action asserts fraud and overreaching in the transactions by which MTA purchased its initial investments from TALC. (A. 14-16.) It attacks a course of conduct whereby Transamerica, TAMA and TALC effectively transferred TALC's entire portfolio to a passive MTA, whose trustees allowed the transaction without exercising their own judgment in assessing the investments; and charges that, as a result, MTA received a low-quality portfolio, in a transaction designedly for the benefit of Transamerica, TALC and MTA. (A. 15, 16.)

The third cause of action asserts additional fraudulent and manipulative conduct in the course of performance of the advisory agreement. It charges that, due to the relationship between TAMA and Transamerica, and their dominance and control over MTA, they retained the most desirable opportunities for other Transamerica affiliates, passing on less desirable investments to MTA. Once again, violation of the antifraud provisions of the Advisers Act as well as of the advisory agreements is alleged. (A. 16-18.)

Issue was never joined. Rather, petitioners here moved to dismiss and for summary judgment in March 1974. By that time, the action had been transferred to the Northern District of California. (A. 1.)

Although numerous grounds for dismissal or summary judgment were urged by petitioners, only one was decided by the District Court. It granted the motion to dismiss, saying, "since Section 206 . . . affords no private right of action . . . the Court has no jurisdiction of the plaintiff's claims . . . ." (A. 25.) The holding was not limited to the facts of the particular case. While leave to amend was allowed, plaintiff declined to do so; and a final order of dismissal with prejudice was entered on November 21, 1974. (A. 26.)

Respondent appealed to the Court of Appeals, which reversed. (A. 28 *et seq.*) The majority opinion noted that, "in view of the naked holding of a lack of jurisdiction," the District Court had determined only one issue; and that the Court of Appeals would review that issue only. It then answered affirmatively the question presented for review:

> "Accordingly, we hold that the implication of a private right of action for injunctive relief and damages

> under the Advisers Act in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation. The District Court holds subject matter jurisdiction to entertain such actions . . . ." (A. 31.)

The Court of Appeals majority opinion explicitly adopts the "rationale of the majorities in *Abrahamson* and *Wilson*." (A. 31.) The dissent, while noting that "reasonable minds may differ," adopted the basis of the dissent in *Abrahamson*. (A. 32.)

Petitioners sought certiorari, proffering the issue, "May a private right of action be implied under the Investment Advisers Act of 1940?" (*Petition for Certiorari* at 2.) The writ was granted on November 6, 1978, without modification of the question presented by the petition. Petitioners now, in their brief, propose that the question for decision is, "May a private right of action *at law for damages* be implied under the Investment Advisers Act of 1940?" (*Brief for Petitioners* at 2; emphasis added.)

Summary of Argument

Each of the Courts of Appeals that have decided the question has held that private rights of action arise by implication under the Investment Advisers ("Advisers Act"), particularly the antifraud provision, Section 206. This is wholly correct in terms of traditional jurisprudence, applicable federal authority and sound policy. The standards established by this Court, as expressed in *Cort* v. *Ash*, 422 U.S. 66 (1975), and in the context of the federal securities laws, have been followed.

Implication of private rights of action under the federal securities laws is not unique. The concept is founded in authority more than a century old.

The propriety of the implied rights recognized by the Courts of Appeals is illuminated by their genesis. Originally, it was held that, where a statute declared conduct unlawful, and violation of the statute caused harm to a person intended to be protected by it, a private action lay, absent a clear legislative intent to deny the right. In diverse contexts, this doctrine was widely utilized by the state courts; and was given the imprimatur of leading commentators.

This Court, with the refinement that the violation must have harmed a member of the "class for whose especial benefit" the statute was intended, applied the doctrine long ago. *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U.S. 33 (1916). Virtually unchanged in expression and content, it was the core of the first decision to uphold an implied private right of action under the securities laws, *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). This Court and other federal courts have implied private rights under statutes regulating labor relations, telecommunications, navigation and voting rights, as well as the Constitution itself. The present case, and the many decisions implying private rights of action under the securities laws, are thus part of a broader line of authority.

The federal securities laws, including the Advisers Act, are an integrated body of regulatory enactments, serving a common goal: comprehensive national regulation of the securities industry, in order to protect investors; and consequently protecting the capital market and the national economy. The cases upholding Advisers Act claims are supported by the consistent recognition of implied rights of action arising under other securities laws. Section 206 of the Advisers Act is most closely akin to Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder; so that the courts have appro-

priately placed significant reliance, in finding implied private rights under Section 206, upon the overwhelming consensus that they were properly implied under Section 10(b) and Rule 10b-5. There is further strong support for such recognition, particularly in the present case, from the parallel contracting-avoiding provisions of the 1934 Act (Section 29(b)) and the Advisers Act (Section 215(b)), which require private action for their effectuation. Such statutes should be held to give rise to the remedies that will fulfill the congressional purpose in enacting them. To deny such rights and remedies under Section 206 of the Advisers Act would create an unjustified anomaly.

Application of each of the four relevant considerations, or criteria, set forth in *Cort* v. *Ash*, *supra*, points to affirmance of the Court of Appeals here: (1) The statute was enacted for the protection of an especial class, and creates federal rights. (2) There are implicit, if not explicit indications of intention to create such rights; and no indications to the contrary. (3) Implication of private remedies is consistent with the underlying legislative purposes. (4) The cause of action is federal, in an area of particular federal concern, and should be so adjudicated.

Petitioners, as signaled by their unilateral revision of the question on which the Court has granted certiorari, do not squarely meet the issues. Instead, each argument offered for reversal is couched in terms of the alleged absence of support in the statute or its legislative history for implication of a private right of action "at law" for damages. (*E.g.*, *Brief for Petitioners* at 7, 10-21.) This abandonment of a major portion of the question on which certiorari was sought and granted is an effective concession that the decision of the Court of Appeals must be affirmed; and may well call in question whether the writ should not be dismissed. Except for a few scattered, un-

supported assertions, petitioners have conceded that it is proper to allow private equitable actions under the Advisers Act. This case is first and foremost a suit in equity, seeking declaratory and injunctive relief, rescission and restitution, on the basis of fraud and overreaching in the making and performance of an investment advisory contract. On other claims, damages are sought, but the primary character of the suit is equitable. Even were there doubt as to "actions at law," this case, as an equitable suit, is maintainable in the federal court, seeking the relief provided by Section 215(b) for violation of Section 206 of the Advisers Act.

(1) The statute was enacted for the especial benefit of investors in the context of their contractual relationships and other transactions with investment advisers; which is manifested by its regulatory and antifraud provisions and by Congress' articulated fundamental purpose: to protect investors from fraud and misrepresentation by unscrupulous advisers. The first question posed in *Cort* v. *Ash*, 422 U.S. 66 (1975), must be affirmatively answered. A federal right is created by the statute.

(2) The explicit or implicit indication of legislative intent, which favors implication of private rights of action, is in the Advisers Act *per se*, and the unambiguous declarations of its purpose. Sections 206 and 215(b), properly interpreted, indicate implicit intent favoring implication of a private right of action. The primary and legitimate sources of legislative history are silent on the subject of private actions, and barely descriptive of the pertinent provisions. The essential purpose of the statute is, however, firmly, even bluntly, stated; and the secondary sources relied on by petitioners as diluting or negating that purpose are either silent or utterly beside the point; or support respondent's position. Given the

text and purpose of the relevant provisions, the courts should make available remedies to protect the rights created.

Absence of the phrase "actions at law" from Section 214 of the Advisers Act neither excludes jurisdiction over private actions nor manifests an intention to preclude them. Section 214 was so described, in all legislative materials, as to require the conclusion that Congress did not perceive it as differing, in any material aspect, from the congruent provision of the Investment Company Act, which, like the earlier securities statutes, did contain the phrase. Section 214 has virtually no legislative history of its own; and what there is explains nothing. There is no warrant in Section 214 for dilution of the substance of the antifraud section or for nullification of the rights obviously embodied in Section 215(b). Section 214 does not manifest any purpose of Congress to disallow recognition of the implied rights that will provide effective recourse for violations of the Advisers Act.

Proper application of the second of the *Cort* v. *Ash* criteria also favors recognition of implied rights of action, to vindicate the legislative purpose of the statute.

(3) Similarly, implication of private rights of action is consistent with the underlying purpose of the legislative scheme. That underlying purpose is the already-described fundamental purpose. There is no conflict between the central thrust of the regulatory scheme and any co-existing or subsidiary aims. Such inconsistency has been found only where the statute involved created no federal right in the plaintiff, or where recognition of a private claim would interfere with a comprehensive legislative scheme for administrative enforcement.

Agency enforcement of the Advisers Act, like the other securities laws, is complemented, not hampered, by the exercise of private rights. Thus, once the first two relevant criteria are satisfied, it should follow that the third is met. In the proper sense, private actions are necessary to enforcement; since the Securities and Exchange Commission cannot alone enforce the statute so as fully to protect investor interests.

(4) Protection of investors, *vis-a-vis* investment advisers, is a federal concern. The Advisers Act creates federal rights in them. Federal courts should vindicate those rights. It is no answer that there may exist analogous state law causes of action. This is true of most cases where implied federal rights have been recognized. Analogous state law claims are recognized to be ill-adapted or simply inadequate. Uniform federal law should provide the substantive context of federally created rights. The fourth of the *Cort* v. *Ash* questions should be answered in the negative.

That this Court has defined and limited certain rights arising under the securities laws is not precedent for reading the Advisers Act to confer no rights. The suggestions of excessive and ill-founded litigation, made as petitioners' "practical" policy argument, are unsupportable chimera, and the asserted facts and characterizations offered in support are significantly false—in addition to being outside the record.

The federal courts are, and should continue to be, a forum for the proper interpretation and application of federal law, especially in fields of national concern. The regulation of the securities industry is one such field. That is the controlling policy consideration. The decision of the Court of Appeals should be affirmed.

ARGUMENT

I.

Implication of Private Rights of Action Under Section 206 of the Advisers Act Is Called for by Consistent Application of Precedent in General Federal and Common Law Jurisprudence.

Each of the three Courts of Appeals that has recognized the propriety of an implied private action for equitable relief and for damages as arising under Section 206 of the Investment Advisers Act of 1940, in the case at bar, in *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), and in *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), has built upon the prior decisions of this Court upholding the implication of such claims under comparable statutes, and other federal authority in securities and related areas of law. These lines of authority arise, in turn, from firmly rooted concepts in Anglo-American jurisprudence.

Further, these Courts have carefully adhered to the standards established in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), and *Cort* v. *Ash*, 422 U.S. 66 (1975). Recognition of an implied right of action under Section 206, is conceptually no more novel than recognition of such rights under antifraud and similar provisions of the related federal securities laws. Review of the origins and development of the underlying principles should guide their application here.

The fundamental concept is that, where the legislature has declared certain conduct unlawful, and where the proscribed conduct is recognized as invading particular rights of a discrete group, or class, of persons, as well as the

sovereign interest, it is appropriate that an action should lie on behalf of an injured member of that class. The principle was clearly articulated more than a century ago by Lord Campbell, in *Couch* v. *Steel*, 3 E. & B. 402, 118 Eng. Rep. 1193 (Q.B. 1854). It was held there that an action on the case lay in favor of a seaman who claimed damages for illness arising from his shipowner's failure, in violation of a penal statute, to maintain certain medicines on board a vessel. Only the count based on the statutory violation was sustained against a demurrer. The Court based its holding on sources still more ancient, saying:

> "The enactment provides a benefit for the seamen; and, according to the plaintiff's allegations in the second count, the defendant has violated this enactment; and thereby the plaintiff, being a seaman on board, was deprived of that benefit, and his health was injured. The general rule is that, 'where a man has a temporal loss, or damage by the wrong of another, he may have an action upon the case, to be repaired in damages;' Com. Dig. Action upon the Case (A). The statute of Westm. 2 (1 stat. 13 Ed. 1,) c. 50, gives a remedy by action on the case to all who are aggrieved by the neglect of any duty created by statute. See 2d. Inst. 486. And in Com. Dig., Action upon Statute (F), it is laid down that, 'in every case, where a statute enacts, or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage, or for the recompence of a wrong done to him contrary to the said law.' Therefore the simple enactment requiring the supply of medicines would have entitled the plaintiff to an action, in the same manner as if the obligation had been imposed by the common law, or had been expressly included in the ship's articles." (3 E. & B. at 411.)

Rejecting the argument that provision of a monetary penalty (recoverable by an informer) had been intended to exclude the right of recovery by the party injured, the Court held that absent statutory language explicitly denying the right, a breach of statutory duty causing special damage to an individual plaintiff, beyond the public wrong, gave rise to an action on the case.

The law thus stated was generally accepted in this country. *See* Thayer, *Public Wrong and Private Action*, 27 Harv. L. Rev. 317 (1914); 5 Loss, *Securities Regulation* 2883-2886 (Supp. 1969). Dean Thayer was clear that, at least in the case of prohibitory statutes, the rule enunciated should apply with few, if any, exceptions:

> "When such a prohibition has been violated and the very evil aimed at by the law has been brought about, approval of the wrongdoer's conduct by the court is not consistent with proper respect for another branch of the government." (27 Harv. L. Rev. at 324.)

The language of *Couch* v. *Steel*, *supra*, was echoed where implication of a private action in tort was squarely upheld by this Court, in *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U.S. 33 (1916), and again in the seminal finding that an implied private right of action arose from an antifraud provision of one of the federal securities laws, *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

In the *Rigsby* case, this Court implied a right in favor of a railroad yard employee, not directly engaged in interstate commerce, to recover for damages for personal injuries arising from violation of a provision of the Federal Safety Appliance Acts[5] requiring maintenance of certain railway car equipment in secure and safe condition. It

[5] *E.g.*, 36 Stat. at L. 298, Comp. Stat. 1913, § 8617.

found that the statute was "intended for the *especial protection* of employees engaged in duties" such as plaintiffs' (241 U.S. at 37; emphasis added). While the statutes contained no express language creating a private right of action for personal injury by an employee, there was an analogous common law right of action. In language strikingly similar to Lord Campbell's, the Court said:

> "A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied, according to a doctrine of the common law expressed in 1 Com. Dig., tit., Action upon Statute (F), in these words: 'So, in every case, where a statute enacts or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage, or for his recompense of a wrong done to him contrary to the said law.' [Citation omitted.] This is but an application of the maxim, *Ubi jus ibi remedium*." (*Id.*, at 39-40.)

In *Kardon* v. *National Gypsum Co.*, *supra*, whether there was personal jurisdiction over certain defendants depended upon whether a private right of action arose by implication under Section 10(b) of the Securities Exchange Act of 1934[6] ("the 1934 Act"), and Rule 10b-5[7] promulgated thereunder. The Court found that the complaint charged acts violating the statute and rule; and that no statute or rule expressly provided a private action for such violation. Judge Kirkpatrick continued:

[6] 15 U.S.C. 78j(b) (1971).

[7] 17 C.F.R. § 240.10b-5.

"However, 'The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect. • • •' Restatement, Torts, Vol. 2, Sec. 286. This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort. As was said in Texas & Pacific R. Co. v. Rigsby, 241 U.S. 33, 39, 36 S. Ct. 482, 484, 60 L. Ed. 874, 'This is but an application of the maxim, Ubi jus ibi remedium.'" (69 F.Supp. at 513.)

Foreshadowing later decisions of both the Courts of Appeals and this Court, Judge Kirkpatrick also considered whether an explicit intention to grant or deny such a remedy could be found in the statute itself, or in the general legislative scheme; rejected the argument that the creation of certain express private rights negatived the implication of others; and found implication of a private remedy appropriate "in view of the general purpose of the Act." (*Id.* at 514).

Adoption of the statutory tort principle in the Restatement of Torts, § 286 (1934),[8] reflecting its widespread acceptance, of course facilitated its application in *Kardon*, and its progeny. Implied rights were found in varying contexts. *See, e.g., Abounader* v. *Strohmeyer & Arpe Co.*, 243 N.Y. 458, 154 N.E. 309 (1926) (food labeling); *H.*

[8] In the Restatement of Torts, 2d, § 286, the formulation of the principle is modified, and stated more flexibly. *See generally* 2 Loss, *Securities Regulation* 935-936 (2d ed. 1961); 5 Loss, *op. cit.*, 2886 (Supp. 1969).

Christiansen and Son Inc. v. *City of Duluth*, 225 Minn. 475, 31 N.W.2d 270 (1948) (obstruction of waterway); *Sapiro* v. *Frisbie, et al.*, 93 Cal. App. 299, 270 Pac. 280 (D. Ct. App. 1928) (zoning violation); *Wolf* v. *Smith*, 149 Ala. 457, 42 So. 824, 9 L.R.A. (N.S.) 338 (1906) (personal injury).

There is no lack of federal authority upholding the implication of private rights of action where the statute in question had been enacted for the benefit of a particular class, and where Congress had not evidenced a purpose to exclude such relief. In *Tunstall* v. *Brotherhood of Locomotive Firemen and Enginemen*, 323 U.S. 210 (1944), this Court, by Mr. Chief Justice Stone, held that petitioner, a Negro fireman, could bring an action for injunctive relief and damages for the failure of the respondent union to represent him "without discrimination because of race," a duty imposed upon the union under the Railway Labor Act (45 U.S.C. § 151 *et seq.*). The Court held that petitioner's claim arose under the statutes of the United States, so that general federal question jurisdiction existed under the predecessor to 28 U.S.C. § 1331. It continued:

"We also hold that the right asserted by petitioner which is derived from the duty imposed by the Railway Labor Act on the Brotherhood, as bargaining representative, is a federal right implied from the statute and the policy which it has adopted. It is the federal statute which condemns as unlawful the Brotherhood's conduct. 'The extent and nature of the legal consequences of this condemnation though left by the statute to judicial determination, are nevertheless to be derived from it and the federal policy which it has adopted.'" (323 U.S. at 213, citations omitted.)

Similarly, the Court of Appeals for the Second Circuit found that a private right of action for damages arose by implication from Section 605 of the Communications Act of 1934 (47 U.S.C. § 151 *et seq.*). In *Reitmeister* v. *Reitmeister*, 162 F.2d 691 (2d Cir. 1947), Judge Learned Hand said:

> "The first questions are whether the Communications Act of 1934 . . . imposes a civil, as well as a criminal, liability upon anyone who 'publishes' a telephone message, and whether, if so, the District Court had jurisdiction over the action. *Although the Act does not expressly create any civil liability, we can see no reason why the situation is not within the doctrine which, in the absence of contrary implications,* construes a criminal statute, enacted for the protection of a specified class, *as creating a civil right in members of the class, although the only express sanctions are criminal. . . . That the District Court had jurisdiction, if there was a civil right, is too plain for debate.*" (162 F.2d at 694; footnotes omitted; emphasis added.)

More recent decisions reconfirm the viability of the doctrine. *Wyandotte Transportation Co.* v. *United States*, 389 U.S. 191 (1967), held that the United States had an implied right of action for damages under Section 15 of the Rivers and Harbors Act of 1899 (33 U.S.C. § 409) against a shipowner who had negligently permitted his vessel to be sunk in a navigable waterway, notwithstanding the existence of explicit criminal penalties for violation of that section, and notwithstanding the existence of explicit civil remedies for violations of other sections of the Act.[9] In *Allen* v *State Board of Elec-*

[9] The authority relied on included, *inter alia*, *Texas & Pacific Ry. Co.* v. *Rigsby*, *supra*, *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), and the Restatement (Second) of Torts, § 286.

tions, 393 U.S. 544 (1969), the Court held that there was an implied right of action under Section 5 of the Voting Rights Act of 1965 (42 U.S.C. § 1973 *et seq.*), enabling a private citizen to seek declaratory judgment that a state had violated Section 5 in enacting new voting statutes, as well as injunctive relief against enforcement of the state statutes. The Court emphasized the broad purposes of the Act to assure voting rights to all citizens and the ineffectiveness of enforcement by the federal government alone, and reiterated:

> "We have previously held that a federal statute passed to protect a class of citizens, althougn not specifically authorizing members of the protected class to institute suit, nevertheless implied a private right of action." (*Id.* at 557.)

Still more recently, in *Bivens* v. *Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388 (1971), this Court implied a private right of action for damages in favor of plaintiffs who alleged injury arising out of an unlawful search and arrest, in violation of rights guaranteed by the Fourth Amendment to the Constitution.

The many cases upholding private rights of action implied from provisions of the federal securities laws therefore lie well within the mainstream of a broader current of authority.

II.

Consistent Recognition of Implied Private Rights of Action Under Related Federal Securities Laws Militates Strongly for Recognition of Such a Right of Action Under Section 206 of the Advisers Act.

Quite aptly, the Courts in *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), and *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), as well as in the case at bar, drew substantial support for their holdings from the consistent recognition of implied rights of action on behalf of the protected class of investors under Section 10(b) of the 1934 Act and Rule 10b-5, Section 14(a) of the 1934 Act,[10] the Investment Company Act of 1940[11] ("Investment Company Act") and the Public Utility Holding Company Act of 1935.[12] (*See* 568 F.2d at 873.)

There is an unmistakably close correspondence between Section 206[13] of the Advisers Act and Section 10(b) of the 1934 Act and Rule 10b-5.[14] The existence and propriety

[10] 15 U.S.C. § 78n(a) (1971).

[11] 15 U.S.C. § 80a-1 *et seq.* (1971).

[12] 15 U.S.C. § 79 *et seq.* (1971).

[13] Section 206, in pertinent part, declares it unlawful for an investment adviser,

"(1) to employ any device, scheme or artifice to defraud, any client or prospective client;

"(2) to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client;

• • •

"(4) to engage in any act, practice or course of business which is fraudulent, deceptive or manipulative. . . ."

[14] Rule 10b-5, in pertinent part, declares it unlawful,

"(1) to employ any device, scheme or artifice to defraud,

• • •

of implied private rights of action for damages, as well as for injunctive relief, under the latter provisions, are too well settled to require extensive discussion. As this Court noted in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975):

> "This Court had no occasion to deal with the subject until 25 years later, and at that time we confirmed with virtually no discussion the overwhelming consensus of the District Courts and Courts of Appeals that such a cause of action did exist. . . . Such a conclusion was, of course, entirely consistent with the Court's recognition in J. I. Case Co. v. Borak . . . that private enforcement of Commission rules may '[provide] a necessary supplement to Commission action.'" (*Id.* at 730.)

It is instructive that the determinations that contributed most strongly to that "overwhelming consensus" relied upon traditional doctrine. For example, in *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951), the Court wrote:

> "Section 10(b), to be sure, does not explicitly authorize a civil remedy. Since, however, it does make 'unlawful' the conduct it describes, it creates such a remedy." (*Id.* at 787; footnote omitted.)

Important support for this view arises from Section 29(b) of the 1934 Act,[15] which, like Section 215(b) of the Advisers Act, "provides that contracts in violation of any provision of the Act shall be void." *Kardon* v. *National*

"(3) to engage in any act, practice or course of conduct which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

[15] 15 U.S.C. § 78cc (1971).

Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946). Judge Kirkpatrick reasoned that:

> "It seems to me that a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it. The statute would be of little value unless a party to the contract could apply to the Courts to relieve himself of obligations under it or to escape its consequences." (*Id.*)

The Courts of Appeals that upheld the implication of private rights of action under the Investment Company Act had no greater difficulty. In *Moses* v. *Burgin*, 445 F.2d 369 (1st Cir.), *cert. denied*, 404 U.S. 994 (1971), the Court noted that defendants hardly disputed that the Investment Company Act "impliedly authorizes the courts to grant civil recovery if their conduct fell within the scope of the phrase 'gross misconduct or gross abuse of trust' contained in Section 36 of the Act, 15 U.S.C. § 80a-35." (*Id.* at 373.) The Court considered the implication appropriate, upon its own findings of an apparent legislative purpose to protect shareholders of investment trusts against self-dealing by those who managed the funds; of the utility of private actions as a supplement to SEC activity; and of the "general grant of jurisdiction to 'enforce any liability or duty created by' the Act." (*Id.*) *See also Brown* v. *Bullock*, 194 F. Supp. 207 (S.D.N.Y. 1961), *aff'd en banc*, 294 F.2d 415 (2d Cir., 1961); *Taussig* v. *Wellington Fund, Inc.*, 313 F.2d 472 (3d Cir.), *cert. denied*, 374 U.S. 806 (1963); *Esplin* v. *Hirschi*, 402 F.2d 94 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); *Herpich* v. *Wallace*, 430 F.2d 792 (5th Cir. 1970).

This Court first upheld an implied private right of action under the securities laws in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). It determined that Section 14(a) of the

1934 Act, regulating proxy solicitations, was enacted to prevent the obtainment of "authorization for corporate action by means of deceptive or inadequate disclosure" and that the beneficiaries of these "broad remedial purposes" were principally the group of investors who were the stockholders of the subject corporation. *Id.* at 431, 432, respectively. It was equally plain to the Court that the Securities and Exchange Commission could not enforce this provision alone and thus that "[p]rivate enforcement of the proxy rules provides a necessary supplement to Commission action". (*Id.*). The Court said:

> "We, therefore, believe that under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." (377 U.S. at 433.)

The federal securities laws, including the Advisers Act, are an integrated body of legislation, constituting a comprehensive regulatory scheme intended by Congress to eliminate a variety of "abuses in the securities industry." *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 at 186 (1963); *Abrahamson* v. *Fleschner*, 586 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978). The settled propriety of implied private rights of action under the provisions of these laws aimed at elimination of fraud, deception and similar overreaching is a strong basis for implying private rights under Section 206. To hold otherwise would be to create an unjustifiable anomaly.

The standards established by this Court for recognition of implied private rights of action are satisfied here. In *Cort* v. *Ash*, 422 U.S. 66 (1975), four relevant considerations were articulated:

> "First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted,' Texas & Pacific

> R. Co. v. Rigsby, . . . (emphasis supplied)—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, ether to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?" (422 U.S. at 78; citations omitted.)

Although these four considerations are interdependent, it will be useful to discuss them separately.

III.

The Protection of Investors in Their Relationships With Investment Advisers Was a Fundamental Purpose of the Advisers Act. The Statute Is for Their Special Protection, and Creates Federal Rights in Their Favor.

The Advisers Act was passed out of a well-founded and particularized concern for the protection of investors in the context of their dealings and agreements with investment advisers. *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963); *see also Abrahamson* v. *Fleschner, supra; Wilson* v. *First Houston Investment Corp., supra; Bolger* v. *Laventhol, Krekstein, Horwath & Horwath*, 381 F. Supp. 260 (S.D.N.Y. 1974); *Sullivan* v. *Chase Investment Services of Boston Inc.*, 434 F. Supp. 171 (N.D. Cal. 1977); *Angelakis* v. *Churchill Management Corp.*, CCH Fed. Sec. L. Rep. ¶ 95,285 (N.D. Cal. 1975).

Full and consistent support for this finding arises from the genesis and legislative history, as well as the provisions, of the statute.

The Advisers Act, like the Investment Company Act, has its roots in a study made by the Securities and Exchange Commission at the direction of Congress.[16] The SEC Report showed that the abuses of investors' interests "prevalent among investment companies" were by no means foreign to the investment advisory business. Particularly, it pointed to dangers presented by advisers "who indulged in exaggerated claims"; by conflicts of interest between investment advisers and their clients; by conflicts, self-dealing and similar problems arising out of affiliations between investment advisers and those who marketed securities to investors; and by the existence of compensation arrangements, including contingent compensation arrangements, which encouraged the adviser to recommend investments involving untoward risks. (SEC Report at 28-30.)

The "declaration of policy," embodied in Section 202 of the bill as originally introduced,[17] recited its recognition of an adverse effect on the interest of investors:

> ". . . (4) When the business of investment advisers is so conducted as to defraud or mislead investors, or to enable such advisers to relieve themselves of their fiduciary obligations to their clients."

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[16] Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on investment counsel, investment management, investment supervisory and investment advisory services, H.R. Doc. No. 477, 76th Cong., 2d Sess. (1939), hereinafter "SEC Report."

[17] S. 3580, 76th Cong., 3d Sess. (1940).

The intent of the legislation was "to mitigate, and, so far as is presently practicable to eliminate the abuses enumerated. . . ." (*Id.*) While this text was not in the Advisers Act as finally enacted, it remains an accurate description of its fundamental purpose.[18]

The point is stated with equal force in the reports of the Senate and House committees that accompanied the ultimate version of the Act. The report of the Senate Committee on Banking and Currency declared that federal legislation was necessary, in that "protection of investors requires the regulation of investment advisers on a national scale," so as to solve "the problems and abuses of investment advisory services. . . ." (S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).)

The House Committee on Interstate and Foreign Commerce emphasized in its report the need "to protect the public from the frauds and misrepresentations" of dishonest advisers and also to protect honest investment advisers against unwarranted stigmatization "by making fraudulent practices by investment advisers unlawful." (H.R. Rep. No. 2639, 76th Cong., 3d Sess. 28 (1940).)

In the face of this legislative history, petitioners concede that a basic purpose of the Act is "to protect investors who retain investment advisers." (*Brief for Petitioners* at 12.) This correct concession, we submit, is an admission that the first criterion of *Cort* v. *Ash*, 422 U.S. 66, 78 (1975), is met. Petitioners attempt to avoid

[18] As this Court said in *SEC* v. *Capital Gains Research Bureau*, *supra*, the language was deleted, without altering the substance of the Act, upon the protestations of industry witnesses that all investment advisers should not be publicly condemned for the acts of some; and not because of any congressional doubt that abuses had occurred in the past or that their mitigation or elimination required federal legislation. (375 U.S. at 191 n. 34.)

its force by suggesting that the inquiry should be whether Congress intended especially to benefit investors "seeking money damages for violation of the Act." (*Brief for Petitioners*, at 11, 14.) But in *Cort*, as in all of the authorities, the "class" is unmistakably defined in terms of its pre-litigation or non-litigation characteristics, and in terms of the effects, or potental effects, of the prohibited conduct upon it; not by the way in which redress is sought. *See, e.g., J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964).

Another pointless evasive tactic is the suggestion that the basic purpose is somehow diluted by the co-existence of other purposes. (*See Brief for Petitioners*, 15-16; 22-23.)

The federal securities laws are avowedly multi-purpose statutes.[19] Their enactment was motivated by the realization that the structure and practices of the securities industry had contributed substantially to the causes of the great depression; and that a regulated, orderly and better behaved capital market was a prerequisite to a healthy national economy. *See, e.g., Securities and Exchange Commission* v. *Capital Gains Research Bureau, supra*, 375 U.S. at 186. It has never been suggested that a statute—or the particular provision of a statute in question—is for the protection of "an especial class" only where that is its *sole* purpose. *Cort.* v. *Ash* itself holds that corporate stockholders are not especially protected by the statute at issue because the statute was concerned with them peripherally if at all; being primarily directed at a very different area of concern: the need to limit the influence of concentrated corporate financial power upon the in-

[19] For example, Section 2 of the 1934 Act declares its purposes to include protection of the "national credit," the taxing power and the "national banking system," as well as the "maintenance of fair and honest markets" in securities transactions. 15 U.S.C. § 78b (1971).

tegrity of the electoral process. (422 U.S. at 82.) In *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U.S. 33 (1916), the source of the "especial benefit" rubric, protection of travelers and assurance of "the safety of the main track as a highway of interstate commerce," were as significant among the purposes of the statute as the safety of employees. (241 U.S. at 41.) That plaintiff was a member of *one* of the groups especially protected was quite enough.

Section 206, prohibiting fraudulent or deceptive practices, was a part of the Advisers Act from the first draft onward; as was a provision (enacted as Section 215(b)) voiding contracts made or performed in violation of the Act. *Securities and Exchange Commission* v. *Capital Gains Research Bureau, supra.* The desirability of these provisions was never debated, and was presumed by all parties.

It is therefore immaterial that, in some provisions of the Act, the powers granted the SEC were less sweeping than originally proposed. That the Act may have had the additional purpose to cause a compulsory census of the industry—which is a dubious interpretation of early legislative history—is hardly in derogation of its explicit, fully articulated, primary purpose—the protection of investors in the context of their dealings and relations with investment advisers. (See Point IV A, *infra*, p. 30.)

The instant case is brought on behalf of a party within the especially protected group, as were the other actions where a private right of action under Section 206 has been recognized. This case is essentially derivative,[20] and the claims asserted are those of MTA. As is undisputed, MTA is an investor in a contractual relationship with its adviser. It is alleged that the making and performance of the advisory contract involved conduct in violation of Section 206; that the contract itself was unilaterally imposed upon MTA by respondent, due to, and through the exercise of, their control and domination of MTA and its trustees; and that by design the provisions for computation of the advisory fees paid and to be paid under the contract were fraudulent, deceptive and grossly unfair (A. 8-11). Further, it is alleged that a manipulative course of conduct pervaded the relationship. Because of the control of MTA by its sponsor (Transamerica), which also controlled its adviser (TAMA), it is charged that MTA, to its disadvantage, acquired much of its initial investment portfolio from a corporation (TALC) having a comomn parent with its adviser (A. 14). It is also charged that, in the performance of the contract, MTA was harmed in its interest as an investor due to the conflict of interests arising out of the TAMA-Transamerica relationship, in that the best available investments were not offered to MTA (A 17). The abuses asserted here are of the very type that the SEC Report, *supra*, particularly noted; and that the Advisers Act renders unlawful. *Cf. Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969). *Accord, Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971).

[20] While class claims were originally asserted, class determination was never sought (A. 1).

In *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), and in *Abrahamson* v. *Fleschner*, 568 F. 2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978), plaintiffs were investors who had committed funds to the management of investment advisers, and each charged fraudulent concealment and misrepresentation with respect to the advisers' investment management policies and practices; clearly the sort of abuses at which the Advisers Act was aimed.

Thus, the Courts of Appeals that have held that these plaintiffs met the first criterion established in *Cort* v. *Ash*

were correct. Its content has not changed since it was first articulated. *See, e.g., Piper* v. *Chris-Craft Industries Inc.,* 430 U.S. 1 (1977). Proper application of this criterion requires the conclusion that Section 206 of the Advisers Act creates a federal right in favor of investors, with respect to their dealings with investment advisers; and thus in favor of MTA.

IV.

There Is at Least Implicit Indication That Some Private Rights of Action Were Intended to Be Allowed Under the Advisers Act. There Is No Indication to the Contrary.

The second criterion in *Cort* v. *Ash,* 422 U.S. 66, 78, is whether there is any explicit or implicit indication of legislative intent to create or deny a private remedy. When, as here, the "especial benefit" criterion is met, it is not necessary to "show an intention" to create a private cause of action" in order properly to imply one; but rather to show the absence of "an explicit purpose to deny such cause of action." (*Id.* at 82.)

A. *Explicit or Implicit Indication of Intent to Create Private Remedies Can and Should Be Found in the Statute Itself and Its Stated Purposes; the Legislative History Being Virtually Silent.*

Apart from such inferences as are validly drawn from the regulatory content of the statute itself, and from its articulated primary purpose, there is no evidence that Congress ever considered "the problem of private actions under the Advisers Act at the time of its enactment." *Abrahamson* v. *Fleschner,* 568 F.2d 862, 874 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978). No section of the statute declares that there shall be private actions, nor does any

section declare that there shall not. Were it otherwise, the question now before the Court could not arise. It is the fact that the primary sources of legislative intention —the conscious expressions of Congress in the cognizant committees—neither discuss nor mention the issue.

A strong indication of at least implicit intention to allow private rights of action under the Advisers Act lies in the nature and purpose of Section 206 *per se,* when it is read, as it should be, in conjunction with Section 215(b) (*see* pp. 40-41, *infra*); and in the light of the paucity of specific legislative history on which to rely. It is beyond dispute—and has been effectively conceded—that there is clear evidence of the propriety of an implied (if not explicit) private equitable claim; and, again, this is dispositive of the present action. Since the argument has been made, however, that an intention to exclude private rights of action can be gleaned from legislative materials (*Brief for Petitioners* at 14-21), analysis and response are required.

The first and best sources of legislative history are the House Report and Senate Report that accompanied the legislation to the floor of Congress. *United States* v. *International Union, UAW-CIO,* 352 U.S. 567, 585 (1957); *American Airlines, Inc.* v. *Civil Aeronautics Board,* 365 F.2d 939, 949 (D.C. Cir. 1966). These represent the prevailing views of those most responsible for the legislation, and are the documents—perhaps the only ones—that can fairly be presumed to have been considered by Congress as a whole.

Each of these reports is simple, terse, descriptive and unenlightening as to the precise issue here.[21] In each, the

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[21] In reporting jointly the two proposed statutes, each report devotes the great preponderance of its text to the Investment Company Act (Title I of the bill presented), and rather limited attention to the Advisers Act (Title II of that bill). The House Re-

only section of the Advisers Act having any bearing on the issues here receiving individual mention is Section 206.

The House Report regarding Section 206 says:

> "This section makes unlawful transactions and practices by investment advisers which defraud or operate as a fraud or deceit upon clients or prospective clients." (H.R. Rep. No. 2639, 76th Cong., 3d Sess. 30 (1940).)

The Senate Report says:

> "Transactions and practices which defraud or operate as a fraud or deceit upon clients or prospective clients are prohibited." (S. Rep. No. 1775, 76th Cong., 3d Sess. 22 (1940).)

There is no separate discussion in either the House Report or the Senate Report of any other provision of the Act which may bear upon the question before this Court. As to Section 214, the keystone of the argument for reversal, the substance and the sum of its primary history follows. The House Report says, "These sections [§§ 208-221] contain provisions comparable to those in title I." (H.R. Rep. No. 2639, *supra,* at 30.) The Senate Report says no more. *See* S. Rep. No. 1775, *supra,* at 23. The invited cross-reference to the congruent jurisdictional provision, Section 44 of Title I, the Investment Company Act, reveals, in the full text of the House Report: "Contains the usual provisions regarding jurisdiction and venue of offenses and suits." (H.R. Rep. No. 2639, *supra,* at 26. *See also* S. Rep. No. 1775, *supra,* at 20.)

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port on Title II, which is in slightly greater detail than the Senate Report, is less than four printed pages in length. (H.R. Rep. No. 2639, 76th Cong., 3d Sess., 27-30 (1940)).

As with the relevant reports, a careful review of the House Hearings[22] and the Senate Hearings[23] also reveals nothing whatever about Section 214, nor was it discussed or debated on the floor of either house.[24] Absent some striking secondary evidence to the contrary, then, the scope, thrust and meaning of the relevant section of the Advisers Act must be gleaned from their text, in the light of the manifest purposes and the overall scheme of the statute, and in the context of accepted principles of substantive law.

Petitioners insist, however, that striking evidence of an intention to deny a private right of action at law is to be gleaned from secondary sources; such as statements of witnesses; subsequent congressional action or inaction on proposed amendments; the absence of specific private right provisions; and an inferential history of the text of Section 214. (*Brief for Petitioners* at 15-21.)

It is suggested that the declared regulatory purposes and provisions of the statute should be taken at less than face value because an SEC witness stated that the "basic approach" of Title II was to effect a "compulsory census" of the industry.[25] The witness did make that statement, early in the proceedings. Senate Hearings at 48. But this conciliatory approach was not even credited by the industry, once it had examined the bill—and it was surely not the approach or purpose of the enacted legisla-

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[22] Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. (1940) [hereinafter "House Hearings"].

[23] Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940) [hereinafter "Senate Hearings"].

[24] For House floor discussion, see 86 Cong. Rec. 9807-19 (1940).

[25] (*Brief for Petitioners* at 15, 22.)

tion. Later, the vice president of the Investment Counsel Association of America, Inc., Douglas T. Johnston, appearing before the Senate committee, protested vigorously that the Advisers Act "is a far cry from the simple census proposed at that time." (Senate Hearings at 712.) He continued:

> "If a simple census can develop into a bill with the *broad regulatory provisions included in title II,* can one not be excused for wondering how the discretionary powers given in the bill would actually be used?" (*Id.*, emphasis added.)

Of course, the statements of witnesses are a relatively unreliable source of Congress' intent, especially if they conflict with the final reports to each house. *See American Airlines Inc.* v. *Civil Aeronautics Board,* 365 F.2d 939, 948 (D.C. Cir. 1966), and authorities cited therein; *see also Railroad Retirement Board* v. *Duquesne Warehouse Co.,* 149 F.2d 507, 510 (D.C. Cir. 1945), *aff'd,* 326 U.S. 446 (1946).

But Mr. Johnston was right. Whatever the importance of the information-gathering provisions of the Advisers Act, and whatever compromises were effected outside the record, both committees reported, and Congress passed, an act whose "essential purpose" was "to protect the public from . . . frauds and misrepresentations. . . ." (House Report No. 2639, *supra,* at 28.) No compromise affected the enactment of Section 206 or Section 215(b).

No more can an intent to deny implied private rights of action be derived from the absence of provisions explicitly creating private actions at law in the Advisers Act, as contrasted, *inter alia,* with the Investment Company Act. The argument was most recently rejected by this Court in *Cort* v. *Ash,* 422 U.S. 66, 82 n. 14. There, petitioners argued that Congress' provision of explicit private remedies in Title III of the Federal Election Campaign Act of 1971, and its failure to provide express civil remedies for violation of the criminal statutes amended by Title II of that Act, required the inference that Congress intended to exclude any private remedy arising out of the latter criminal statutes. Tersely, the Court rejected the contention, saying: "We find this excursion into extrapolation of legislative intent entirely unilluminating." (*Id.* at 82 n. 14.)

The same, and similar and even more sophisticated, arguments were utilized in connection with the implication of private rights of action under Section 10(b) of the 1934 Act, and Rule 10b-5. It was vigorously urged that the provision of explicit private rights of action in Sections 11 and 12 of the 1933 Act, as well as in Sections 9 and 16(b) of the 1934 Act, rendered the implication of private rights under Section 10(b) and Rule 10b-5 either anomalous or in conflict with congressional intention. *See generally* 3 Loss, *Securities Regulation* 1778-1792 (1961). Despite Professor Loss' fear that the perceived anomalies might cause judicial elimination of all implied private rights under that section and Rule, those arguments were rejected. *See, e.g., Fischman* v. *Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir. 1951).

The logic of petitioners' argument is more seriously flawed in this case because the Advisers Act plainly does provide for some private actions to redress violation of its regulatory provisions. Section 215(b) does permit the maintenance of a private action for equitable relief for such violations. Professor Loss has stated (referring to Section 29 of the 1934 Act) that the right granted by such a contract-avoidance provision is 'perhaps more express than implied." (3 Loss, *supra,* at p. 1759.) And there is no doubt but that Section 214 at least confers jurisdiction

over such actions. *See Abrahamson* v. *Fleschner,* 568 F.2d at 879, 882 n. 8 (Gurfein, J., dissenting).

Petitioners' strained effort to draw significance from Congress' amendment or non-amendment of the Advisers Act at various times between 1960 and 1977 is even less illuminating, there being no showing that Congress actually considered whether provision should be made for private actions in the Advisers Act, and actually decided to exclude them. This Court has uniformly held that, where a proposition has never been overtly considered, it cannot be deemed to have been either accepted or rejected. *Trailmobile Co.* v. *Whirls,* 331 U.S. 40 (1947); *Hust* v. *Moore-McCormack Lines,* 328 U.S. 707 (1946).

In 1960, Congress did indeed enact certain amendments to the Advisers Act. Pub. L. No. 86-750 (1960). But there is nothing in that enactment, nor in its legislative history, giving the slightest indication that Congress considered the issue of Commission enforcement *vis-a-vis* the desirability or undesirability of private enforcement—much less that it considered and concluded that only the SEC should enforce the Act. (*Compare, Brief for Petitioners* at 18.) The text and history of the 1960 amendments to the Advisers Act (Pub. L. No. 86-75 (1960)) show that the question of provision for private actions was never presented to Congress, let alone considered by it. The amendments, proposed to Congress by the SEC, were tailored specifically to respond to problems perceived by the Commission as hampering its enforcement efforts. H.R. Rep. No. 2179, 86th Cong., 2d Sess. 3 (1960); S. Rep. No. 1760, 86th Cong., 2d Sess. 2 (1960). Congress again focused on, and strengthened, the antifraud provision of the Act. It amended Section 206 to extend its coverage to unregistered investment advisers, and to empower the SEC to promulgate rules and regulations describing and proscribing fraudulent, manipulative and deceptive courses of conduct. Pub. L. No. 86-750, § 8, 9, 74 Stat. 885 (1960). To that extent, what Congress did in 1960 favors implication. What it did not do, and was not asked to do, and did not consider, is utterly valueless data.

The 1970 amendments to the Investment Company Act, and the accompanying amendments to the Advisers Act (Pub. L. No. 91-547 (1970), are immaterial. Once again, Congress never focused on the question whether the Advisers Act should, or already did, permit private actions, either at law or in equity. That Congress created a new private right of action under the Investment Company Act is in itself irrelevant. *See Cort* v. *Ash, supra,* 422 U.S. at 82 n. 14.

The overwhelming concern of Congress, in considering and enacting these amendments, was to remedy inadequacy in the regulation of the mutual fund segment of the securities industry that had been highlighted in the Wharton School Study of Mutual Funds, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962). *See* S. Rep. No. 91-184, 91st Cong., 1st Sess., 1-3 (1969). In that particularized context, Congress considered and dealt with the problem of assuring effective redress where excessive and unjustified advisory fees had been paid by mutual funds to their advisers. This alone led to the enactment of Section 36(b) of the Investment Company Act. *See* 15 U.S.C. § 80a-35(b). Contrary to petitioners' claim, there was no consideration of the general question of "liability of investment advisers." [26] (S. Rep. No. 91-184, *supra,* at 5-7, 15-17; *see also* H.R. Rep. No. 91-1381, 91st Cong., 2d Sess., 12-13 (1970). The amendments to the Advisers Act were almost entirely to maintain consistency with provisions of the Investment Company Act; and the few exceptions have no bearing on

[26] *Brief for Petitioners* at 19.

the private actions issue. The descriptive text contained in the Senate Report, and cited by petitioners (*Brief for Petitioners* at 19), casts no light whatever upon the relevant purposes of the Advisers Act; and certainly in no way modifies the intentions expressed by the Congress that enacted that Act. *See, e.g., United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 170 (1968), and authorities there cited.

With good reason, this Court has routinely rejected efforts to draw inferences from the inaction, or incomplete action, of Congress upon legislation introduced at the behest of an administrative agency, and there is no basis to change that rule to give any significance to the introduction of amendments to the Advisers Act in 1976 and 1977, or to Congress' inaction thereon. *United States* v. *Southwestern Cable Co., supra; Wong Yang Sung* v. *McGrath,* 393 U.S. 33 (1950).

The SEC and the cognizant Senate committee explicitly stated that the purpose of the proposed 1976 and 1977 amendments was to clarify, and not to change, the law relating to private actions under the Advisers Act. 1975-76 CCH Fed. Sec. L. Rep. ¶ 80,341 (Investment Advisers Act Release No. 491, Dec. 15, 1975); S. Rep. No. 94-910 94th Cong., 1st Sess., 8-9 (1976). There was, at the time, a split in the federal district courts on the question now before this Court; and the SEC desired to resolve the question, if possible, through legislation. (*Id.*) As Mr. Justice Harlan wrote, in *United States* v. *Southwestern Cable Co., supra,* ". . . administrative agencies should, in such circumstances, be encouraged to seek from Congress clarification of the pertinent statutory provisions." 392 U.S. at 170 (citations omitted).

In its report, the Senate committee stated its view that "[i]t is anomalous to deny advisory clients the right to

recover damages as a result of a violation of the Advisers Act when private rights of action in the same circumstances have been implied by the courts under other Federal securities laws." (S. Rep. No. 94-910, *supra,* at 8). The committee, however, voiced optimism, saying that it expected the courts would apply "established legal principles" in deciding whether, and under what circumstances, an implied right of action should be recognized under the Advisers Act. (*Id.,* at 9.)

It is pointless to speculate whether the absence of further congressional action was due to satisfaction with developing judicial interpretation, the press of other, more urgent matters, or even inertia. The amendment was never approved or disapproved. Any sense of urgency, if it ever existed, may well have been vitiated by the soon-to-follow decisions in the *Abrahamson* case, the *Wilson* case and the case at bar. It is impossible to say; and impossible to say not. Like the record prior to the passage of the Advisers Act, the subsequent history only leads back to the statute itself, and its basic premises.

B. *The Advisers Act and Its Articulated Essential Purposes Sufficiently Indicate Congressional Intention to Allow Some Private Actions; and There Is Explicit Provision for Equitable Actions.*

At least implicit intention to allow some private actions for violation of Section 206 appears in the character of that section as such. It declares fraudulent, deceptive and, since 1960, manipulative conduct unlawful in order to protect an especial class of persons, thus meeting the first of the *Cort* v. *Ash* criteria. This alone is substantial evidence of an implicit legislative intent to permit appropriate remedies to be framed by the courts for enforcement of the right so created, *Fischman* v. *Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir. 1951); particularly where the pro-

priety of the implication of such rights was an accepted principle when the statute was enacted. *See e.g., Texas & Pacific Ry. Co.* v. *Rigsby, supra;* Restatement of Torts, *supra,* § 286. Such reasoning led to the proper acceptance of implied rights and remedies under Section 10(b) of the 1934 Act and Rule 10b-5; despite the fact that, as this Court has said, that "there is no indication that Congress, or the Commission . . . contemplated such a remedy . . . ." (*Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 196 (1976).) It is every bit as valid here.

When Section 206 is read, as it should be, in conjunction with Section 215(b), there is quite enough evidence of congressional intention to allow private relief sufficient to dispose of the case before this Court by affirmance of the ruling of the Court of Appeals. The latter provides that any contract "made in violation of any provision" of the Advisers Act, and any contract "the performance of which," or "continuance of any relationship or practice" under, involves violation of any provision of the Advisers Act, "shall be void." It is utterly indistinguishable from Section 29(b) of the 1934 Act, 15 U.S.C. § 78cc(b). The thrust of that section, and of Section 215(b), is that any contract so made or performed, and the continuation of any relationship unlawful thereunder, is "voidable at the option of the deceived party." *See Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 736 (1975); citing *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282 (1940). *See also, Goldstein* v. *Groesbeck,* 142 F.2d 422 (2d Cir. 1944). As this Court noted in *Blue Chip Stamps,* Section 29(b) of the 1934 Act was read, in the leading cases, as supporting the implication of a cause of action for damages under Section 10(b) of the 1934 Act and Rule 10b-5. *See Kardon* v. *National Gypsum Co.,* 69 F. Supp. 512, 514 (E.D. Pa. 1946); *Fischman* v. *Raytheon Mfg. Co.,* 188 F.2d 783, 787

n. 4 (2d Cir. 1951). Section 215(b) is of even greater significance in cases such as this, where a contract is central to the controversy. *See* 3 Loss, *op. cit., supra,* at 1759. *Accord, Abrahamson* v. *Fleschner,* 568 F.2d 862, 882 n. 8 (Gurfein, J., concurring and dissenting).

It is quite sufficient to dispose of the present case in respondent's favor that, unless Section 215(b) is to be nullified, a private right of action for equitable relief under the Advisers Act must be upheld; since only the injured party, and not the SEC, has the "option" to avoid a voidable agreement. *See, Mills* v. *Electric Auto-Lite Company,* 396 U.S. 375, 387-388 (1970), and authorities cited therein. Asserting the invalidity of the advisory agreement between TAMA and MTA, due to violation of, *inter alia,* Section 206, and attacking the transactions between MTA and TALC as well as the performance of TAMA's advisory function under that and other provisions, this action seeks a declaration that the investment advisory agreement was void; a decree avoiding that contract; restitution of the compensation received thereunder; and related relief with respect to the TALC-MTA transactions.

It is elementary that an action to avoid or rescind an agreement is "exclusively equitable in nature," *e.g., Ammerman* v. *Miller,* 488 F.2d 1285, 1295 (D.C. Cir. 1973); and that suit seeking rescission of a contract on account of fraud, and to recover the consideration paid thereunder, may be maintained in equity. *Deckert* v. *Independence Shares Corp., supra,* 311 U.S. at 289 and authorities cited therein. While money damages are also sought in the instant case, equitable jurisdiction remains; and with such jurisdiction the court should dispose of all claims, even if the only remedy found proper is an award of damages on the legal claims. *E.g., McGowan* v. *Parish,* 237 U.S. 285 (1915); *Kinney-Coastal Oil Co.* v. *Kieffer,* 277 U.S. 488

(1928); *Hartford Accident & Indemnity Co.* v. *Southern Pacific Co.*, 273 U.S. 207 (1927). *See also Mendez* v. *Bowie*, 118 F.2d 435, 440 (1st Cir.), *cert. denied*, 314 U.S. 639 (1941).

The leading cases arising under the federal securities laws hold that, where federally created rights are involved and there is thus federal jurisdiction over the controversy, the courts have whatever power is necessary to determine and apply appropriate remedies for violation of these rights. *E.g., J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970). *See also Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U.S. 173 (1942). Surely then, even if the statute here at issue mandates dichotomous treatment of legal and equitable causes —itself an historical anomaly—there is no basis for denying implication of a private equitable action.

In *Abrahamson*, Judge Gurfein's dissent does not take issue with these principles, being explicitly restricted, on the facts of that case, to the question whether "a private action at law for damages should be implied" (at 879). That dissent was explicitly adopted by the dissenting judge in this case. Petitioners, having sought and obtained certiorari on the question whether *any* private right of action arises by implication under the Advisers Act, now restrict their argument to the claimed exclusion of actions at law for damages.[27] But that is not this case; and for this reason alone the decision of the Court of Appeals should be affirmed.

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[27] This is manifest from their statement of the question presented, and permeates thereafter each argument advanced. (*E.g.*, *Brief for Petitioners* at 2, 7, 11, 14, 21, 22, 32.) While so arguing, they do, without citation of authority, suggest that the arguments directed against actions for money damages support the conclusion that no private actions should be allowed. But, in the absence of reasoned explanation, and on a fair reading of their position, this suggestion cannot be seriously regarded.

Nonetheless, so as to deal with the entire question upon which certiorari was granted by this Court, we next consider whether an action that could be characterized as an action at law for damages may arise under the Advisers Act.

C. *Section 214 of the Advisers Act Does Not Exclude Jurisdiction Over an Action at Law for Damages Under the Act; Nor Does Its Language Manifest a Congressional Intent to Bar Private Actions.*

The absence of the phrase "actions at law" from Section 214 of the Advisers Act does not operate to exclude federal subject matter jurisdiction over such actions. The contrary is not seriously contended (*Brief for Petitioners*, 10); nor could it be. That subject matter jurisdiction, as such, existed was common ground between the majority and the dissent in *Abrahamson* v. *Fleschner, supra*, 568 F.2d at 875 n. 22 (majority opinion), 88 n. 5 (dissenting opinion). That there is general federal question jurisdiction over private claims arising by implication from federal positive law, constitutional or statutory, requires no exegesis here. *See, e.g., Bell* v. *Hood*, 327 U.S. 678 (1946); *Bivens* v. *Six Unknown Named Agents of the Federal Bureau of Narcotics*, 403 U.S. 388, 399 (1971) (concurring opinion per Harlan, J.); *Tunstall* v. *Brotherhood of Railway Firemen and Enginemen*, 323 U.S. 210 (1944). Thus, subject matter jurisdiction here also exists under 28 U.S.C. §1331 (1971). *See Brown* v. *Bullock*, 294 F.2d 415, 418 (2d Cir. 1961). In addition, there is respectable authority that the language in Section 214 granting to the federal district courts exclusive jurisdiction over "violations" of the Act is sufficient. *Bolger* v. *Laventhal, Krekstein, Horwath & Horwath*, 381 F. Supp. 260, 264 (S.D.N.Y. 1974); *Osborne* v. *Mallory*, 86 F. Supp. 869, 879 (S.D.N.Y. 1949). Once federal question jurisdiction was established, private rights of action have been

implied in the absence of any special or separate jurisdictional provisions in the relevant statute. *Abrahamson* v. *Fleschner, supra,* at 875 n. 22, citing *inter alia, Texas & Pacific Ry. Co.* v. *Rigsby, supra,* 241 U.S. at 39; *Odell* v. *Humble Oil and Refining Co.,* 201 F.2d 123, 126 (10th Cir.) *cert. denied* 345 U.S. 941 (1953).

Given the overwhelming consensus that private rights of action properly arise under the antifraud provisions of the other federal securities laws, the question, properly stated, is whether an exception should be made of Section 206 because the words "actions at law" are absent from Section 214. The Court in *Abrahamson* v. *Fleschner, supra,* concluded that:

> "There is not a shred of evidence in the legislative history of the Advisers Act to support the assertion that Congress intentionally omitted the reference to 'actions at law' in order to preclude private actions by investors." (568 F.2d at 875.)

The statement is entirely correct. The Congress never considered the language or its meaning; nor were its members ever given to believe that there was anything of moment to consider. When the Advisers Act was brought to the floor of the House, the accompanying committee report informed its members only that Section 214 was "comparable" to the jurisdictional provision of the companion Investment Company Act, Section 44. (H.R. Rep. 2639, 76th Cong., 3d Sess. 31 (1940).) Cross-reference yielded the information that Section 44 "[c]ontains the usual provisions regarding jurisdiction and venue of offenses and suits." (*Id.* at 26-27.) The Senate Report said, if possible, less. S. Rep. 1775, 76th Cong., 3d Sess. 20, 23 (1940).

Had the members of either house referred for enlightenment to the transcripts of the committee hearings, they would have found, in the House Hearings, the statement of SEC attorney David Schenker that "Section 214 covers jurisdiction of offenses and suits." [28] There is nothing else in those hearings, or in the more than 1,000 pages of the Senate Hearings, about Section 214. As to the congruent section of Title I, Schenker had told the House committee that "Sections 43, 44, 45 and 46 all pertain pretty much to well-established existing law." [29]

That is the sum, substance and totality of the legislative history of Section 214, as contained in the primary and most persuasive sources. The portions of the House and Senate Hearings cited in support of the argument that the omission of "actions at law" from Section 214 was intentional, do not even mention the point.[30]

The conclusion necessarily to be drawn is that, to the extent Congress or its committees actually considered the contents of Section 214, they had been given to believe, and had fairly assumed, that the effect of that provision was the same as the effect of all of the other, "usual" jurisdictional provisions of the securities laws.

Rather imaginatively, petitioners suggest, nonetheless, that there was a significant compromise which resulted in the conscious omission of the phrase "actions at law," in negotiations between the SEC and the industry over the text of the Advisers Act. (*Brief for Petitioners* at 8-9, 15-

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[28] House Hearings at 138.

[29] *Id.* at 37.

[30] *See* Senate Hearings at 712-713, 737-754, 1154, cited in *Brief for ICAA* at 3 nn. 3 & 5; House Hearings at 88-90, 92, cited in *Brief for ICAA* at 4 n. 4.

16.) The record is devoid of support for the claim. What does appear is that, at first, the Advisers Act was opposed, *in toto,* by numerous industry spokesmen; that compromises were effected; and that the final legislation had industry acquiescence. But all of this is irrelevant, since the areas of controversy and compromise were unrelated to the issues here. The testimony, in the 1940 House Hearings, of Dwight Rose, on behalf of the Investment Counsel Association of America (hereinafter, "ICAA"), summarizes the controversies, and their resolution.[31]

Neither his testimony, nor any other, supports petitioners' argument.

Petitioners, and the ICAA,[32] also resort to citation of a series of preliminary drafts of the legislation, offered without provenance, to support the claim of congressional intent to exclude actions at law. But such sources are value-

[31] "When the hearings were held on this bill before the Senate committee, the Association opposed it. We opposed it for three general reasons: First, in the original bill there was a confusion between investment counsel and investment trusts. We felt that the personal confidential relationship existing between the investment counsel and this client was so very different from the commodity of investment trust shares which investment trusts were engaged in selling, that any legislation to regulate these two different activities should be incorporated in separate acts. In the bill we felt that our clients were not properly protected in their confidential relationship. In the testimony before the Senate subcommittee there was quite a fight on that. It is not necessary to go into that here. Also we felt that powers given the Securities and Exchange Commission under the bill were unnecessarily broad and would lead to a great deal of uncertainty on the part of anyone who wished to practice his profession as to what might happen to him at any time.

"Following the hearings before the Senate subcommittee, we had conferences with the Securities and Exchange Commission, and all of our objections have been satisfactorily adjusted." House Hearings at 92.

[32] *Brief for ICAA, as Amicus Curiae, in Support of Petitioners* at 3-4.

less where, as here, the "committee changes relied upon were made without explanation." *Trailmobile Co.* v. *Whirls,* 331 U.S. 40 (1947). The Court there rightly declared that:

> "The interpretation of statutes cannot safely be made to rest upon mute intermediate legislative maneuvers." (*Id.,* at 61.)

A fortiori, these sources have no value when the changes, and their significance, were never made a part of the committee deliberations. *See Hust* v. *Moore-McCormack Lines,* 328 U.S. 707 (1946). They constitute no evidence that Congress had the question "presented to its attention," or that it chose one of the alternatives presented. *United States* v. *Pfitsch,* 256 U.S. 547, 552 (1921); *see also Wright* v. *Vinton Branch of Mountain Trust Bank,* 300 U.S. 440 (1937).

Even if the various drafts are considered, they fail to show that there ever was a proposed provision of the Advisers Act from which "actions at law" could have been deleted.[33] There is nothing to explain the changes, to indicate that they were discussed by the Senate or House com-

[33] The early versions of the Advisers Act contained a catchall provision, Section 203, which incorporated by reference more than a dozen sections of the concurrent draft of the Investment Company Act. (*Brief for ICAA, supra,* at 3-4, and Exhibits B, C.) The Investment Company Act jurisdiction section thus incorporated (Section 40(a)) in turn incorporated by reference Section 25 of the Public Utility Holding Company Act of 1935. (*Brief of ICAA, supra,* Exhibits B, C.) The Advisers Act was changed first. A committee print of S. 3580, dated May 24, 1940, includes a new section (then Section 213), specifically dealing with jurisdiction, in substantially the language finally enacted as Section 214. (*Brief of ICAA, supra,* Exhibit C, at A19-20.) No separate jurisdictional section appeared in a draft of the Investment Company Act until, in a committee print of June 4, 1940, the first draft of Section 44 of that title was inserted. (*Brief for ICAA, supra,* Exhibit C, at A25.)

mittees or even to identify the draftsman. All that is really clear is that they were not deemed worth mention. This is the best guide to their proper treatment now.

The absence of the phrase "actions at law" from Section 214 is, on the state of the record, more than adequately explained in *Abrahamson* v. *Fleschner, supra,* 568 F.2d at 874-875. The draftsman provided, in Section 214, for special federal question jurisdiction over only those suits expressly authorized by the Advisers Act. The draftsmen of Section 44 of the Investment Company Act (15 U.S.C. § 80a-43), of Section 22 of the 1933 Act (15 U.S.C. § 77v) and of Section 27 of the 1934 Act (15 U.S.C. § 78aa), in specifying jurisdiction in the district courts over "all suits in equity and actions at law," had done the same. This was necessary to assure such jurisdiction over private civil actions expressly created by those statutes, without reference to the jurisdictional amount, or any other, limiting provision of the general federal question jurisdiction statute, 28 U.S.C. § 1331. It is argued that this explanation is erroneous, and that the express civil liability sections of the earlier acts already conferred such jurisdiction. But the rights-creating provisions of the earlier acts typically provide, as in the case of Section 11 of the 1933 Act, 15 U.S.C. § 77k, only that suit may be brought "in any court of competent jurisdiction . . . ." This language confers no jurisdiction on any particular court; unless another statute establishes that such court *is* one of "competent jurisdiction." Thus, the entirely sensible explanation of the *Abrahamson* majority remains unrebutted.

The necessary conclusion, we submit, is that Section 214 of the Advisers Act has no legislative history worthy of the name. In the absence of any considered determination by either house of Congress as such, or by either cognizant committee of Congress; and in the absence of any testimony

directed to the point even in the hearings before these committees, we submit that whatever thoughts may be ascribed to an unidentified draftsman, never reviewed by those with the power to enact, they are nothing on which to base the argument that the language of Section 214 either excludes, or indicates any congressional intention to exclude, private actions under the Advisers Act.

In this case, then, the answer to the second question posed by *Cort* v. *Ash,* 422 U.S. 66 (1975), is that there are implicit indicia from the regulatory aspects of the statute, in light of Congress' specific statements of its purpose, favoring implication of private remedies. Nothing in the legislative history negates this, or illuminates congressional intention. There is explicit indication that equitable relief is available under Section 215(b), in respect of voidable agreements; and Section 214 does not justify denial of appropriate federal remedies for violation of the Act.

V.

It Is Wholly Consistent With the Underlying Purposes of the Legislative Scheme to Recognize Implied Private Remedies for Violation of Section 206 of the Advisers Act.

The third of the considerations in *Cort* v. *Ash,* 422 U.S. 66, 78, is whether recognition of an implied right of action is consistent with the underlying legislative purposes of the legislative scheme; that is, whether allowance of the remedies sought would further the achievement of the "primary congressional goal." (*Id.,* at 82.)

The broad purposes of the Advisers Act were summarized in *Securities and Exchange Commission* v. *Capital Gains Research Bureau,* 375 U.S. 180, 186:

"The Investment Advisers Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. It was preceded by the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act of 1940. A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." (Footnotes omitted.)

As discussed in Point III, *supra,* the particularized fundamental purpose of the Advisers Act is tersely and bluntly set forth in the reports of the cognizant congressional committees. The House Report declares that:

"The *essential purpose* of title II of the bill is *to protect the public from the frauds and misrepresentations of unscrupulous* tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals *by making fraudulent practices by investment advisers unlawful.*" (H.R. Rep. 2639, 76th Cong., 3d Sess., 28 (1940); emphasis added.)

The Senate Report is equally blunt, contains the same language concerning public protection from "frauds and misrepresentations" and emphasizes that:

"The report of the Commission to the Congress and the record before the committee is clear that the solution of the problems and abuses of investment advisory services—individuals and companies which either handle pools of liquid funds of the public or give advice with respect to securities transactions—cannot be effected without federal legislation." (S. Rep. 1775, 76th Cong., 3d Sess., 21 (1940).)

This is the articulated fundamental purpose, embodied not only in the Reports, but in Section 206 and Section 215 (b). Whether equitable or legal in nature, these rights cannot be inconsistent with—that is, in conflict with—that fundamental purpose.

Petitioners refuse to meet the issue. Instead, they revive the pointless argument that, despite the anti-fraud, and contract-avoiding sections of the Advisers Act, it is no more than a "compulsory census." This has been dealt wtih. (*See* Point IV-A, *supra.*) No more pertinent is the assertion that the limits placed upon the SEC power to generate publicity for its investigations by Section 210 of the Advisers Act have any bearing on the propriety of implied remedies. Section 210 was a specific response to the protestations of industry spokesmen that the mere announcement of an SEC investigation would ruin an adviser; as would the threat that client confidentiality might be unfairly invaded.[34] The fear was recognized as rational in the economic climate of 1940. The limitation is itself narrow. It is grasping at straws to suggest that it manifests an intent to protect advisers from their clients. *Cf. Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977).

No distinction between "goals" and "means" (*Brief for Petitioners* at 23-24) can turn aside the force of the point that the implication of a private right of action is entirely consistent with the statutory purpose to render fraud unlawful; only petitioners' own inaccurate footnote suggests that "negligent" investment advisers would be subject to

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[34] *See* Senate Hearings, 718-723; S. Rep. No. 1775, 76th Cong., 3d Sess., 23 (1940).

such actions (*id.*, at n. 32; see p. 59, *infra*), and there is no authority for the entire *non sequitur*. *Compare S. Rep.* No. 1760, 86th Cong., 2d Sess. 2 (1960).

The cases holding that implication of private rights of action was inconsistent with an underlying legislative scheme demonstrate the interdependence among the several *Cort* v. *Ash* criteria. The conclusion that no federal right in favor of plaintiffs had been created, and that Congress had not intended to do so, was determinative of this third criterion in *Piper* v. *Chris-Craft Industries, Inc., supra;* and *Cort* v. *Ash, supra.* The determination that permission of a private action would interfere with the operations of, and the proper exercise of discretion by, the agency given primary jurisdiction to deal with the problems that brought forth the legislation, was controlling in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975), and *National Railroad Passengers Corp.* v. *National Ass'n of Railroad Passengers,* 414 U.S. 453 (1974). Congress had manifested a specific intent to deny private actions by creating administrative machinery to decide the matters on which court adjudication were sought, and, in the last-cited case, by publicly determining to delete a specific private action provision. Such cases have not the remotest relevance to the case at bar, as was made plain in *Cort* v. *Ash* itself, 422 U.S. at 82 n. 14.

Conversely, allowance of some private actions under the Advisers Act is necessary, in fact, to avoid a clear inconsistency, nullification of Section 215(b). As previously discussed, that statute gives the right of avoidance to the injured party alone (*see Deckert* v. *Independence Shares Corp.*, 311 U.S. 282 (1940)), and failure to allow a private action would nullify it. *See Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

Recognizing the weakness of their suggestion of inconsistency, petitioners shift ground and argue that this Court must find an implied remedy necessary, or deny it. No case so held, after finding that the statute created a federal right in favor of a plaintiff. *Piper* v. *Chris-Craft Industries, Inc., supra,* whence petitioners select this formulation, does not so phrase the criterion; but rather frames it in the language of *Cort* v. *Ash, supra.* It uses the concept of necessity as a term of conclusion, expressing the result of consideration of the questions posed.

Further, in the sense in which the term is used in *J. I. Case Co.* v. *Borak, supra,* implication of a private right of action under Section 206 is a necessary supplement to Commission enforcement. Here, as there, it is clear that the SEC alone cannot effectively enforce the statute. In *Borak,* the Court highlighted the SEC's inability to monitor in timely fashion the approximately 2,000 proxy solicitations that it received each year. Still less is it equipped to review the contracts and activities of all registered and exempt or unregistered investment advisers. Between 1969 and 1975, the number of registered investment advisers more than doubled, from 1,343 to 3,606. S. Rep. No. 94-910, 2 (1976). That growth alone has raised "serious questions" as to the adequacy of the existing mechanisms for enforcement of the Advisers Act. (*Id.*)

As the SEC itself has pointed out, it is not even able to keep informed about the activities of the investment advisers it is supposed to regulate, because investment advisers are not required to file periodic or other reports. (SEC Institutional Investor Study Report, H. Doc. No. 92-64, Part 2, 92d Cong., 1st Sess., at 360 (1971).)

The naked existence of statutory provisions authorizing the Commission to regulate investment advisers so as to prevent, or punish, fraud and like misconduct is meaning-

less. There has not been, and cannot be, any demonstration that the Commission is able effectively to enforce the anti-fraud provision of the Advisers Act.

It follows that consistency with the underlying legislative scheme results from, and even depends on, recognition of private rights of action under the Advisers Act.

VI.

The Federal Courts Should Entertain the Actions That Are Brought to Vindicate Private Federal Rights Arising Under the Advisers Act.

The answer to the fourth question posed by *Cort* v. *Ash, supra,* is, on authority and sound reason, dictated by the answer to the first. In the securities law context, as elsewhere, this Court has declared the law to be that the vindication of federally created rights, and the manner of that vindication, are the business and duty of the federal courts. *J. I. Case* v. *Borak,* 377 U.S. 426 (1964); *Sola Electric Co.* v. *Jefferson Electric Co.,* 317 U.S. 173 (1942); *Textile Workers Union* v. *Lincoln Mills,* 353 U.S. 448 (1957). The contrary result has been reached where, and only where, it has been determined that no federal right in plaintiff's favor had been created. *See Cort* v. *Ash, supra; Piper* v. *Chris-Craft Industries Inc.,* 430 U.S. 1 (1977).

It is no answer to argue, as do petitioners, that claims for violation of Section 206 of the Advisers Act should be relegated to the state courts because they can be restated in the terminology of traditional common law causes of action, *i.e.,* fraud, misrepresentation or, as a catchall, breach of fiduciary duty. Because federal law is built upon the framework of common law jurisprudence, there are few, if any, claims for relief that could not be so restated,

with a modicum of semantic imagination. The existence of such available analogies has not prevented the federal courts from recognizing and implying appropriate federal private rights, whether under the securities laws, in the law of trespass or with respect to torts arising out of violation of federal constitutional rights. *See, e.g., Deckert* v. *Independence Shares Co. Inc., supra; Fischman* v. *Raytheon Mfg. Co., supra; Wyandotte Transportation Co.* v. *United States,* 389 U.S. 191 (1967); *Bivens* v. *Six Unknown Named Agents of the Federal Bureau of Narcotics,* 403 U.S. 388 (1971). It has recently been noted, in *Butz* v. *Economou,* —— U.S. ——, 98 S. Ct. 2894, 2919 (1978) (Rehnquist, J., dissenting), that there is a close correspondence between claims asserted to arise directly under the Constitution and claims describable in terms of the common law.

It is axiomatic that the concepts of fraud inhering in the securities laws, including the 1934 Act and the Advisers Act, were built upon the common law concepts typically embodied in the traditional tort of deceit. 3 Loss, *Securities Regulation* 1430-1444 (1961). But, as Professor Loss there said, "The fact is that the courts have repeatedly said that the fraud provisions in the SEC acts . . . are not limited to circumstances which would give rise to a common law action for deceit." (*Id.,* at 1435.)

To hold otherwise would be to say that "Congress had no purpose in enacting regulatory statutes in this field and that its legislation in the field is meaningless." *Norris & Hirshberg* v. *Securities and Exchange Commission,* 177 F.2d 228, 233 (D.C. Cir. 1949). The federal courts have recognized that state law rights and remedies had proved inadequate to protect the rights of investors in transactions and relationships within the ambit of the federal securities laws. *Securities and Exchange Commission* v. *Capital*

Gains Research Bureau, 375 U.S. 180, 186 (1964); *Fischman* v. *Raytheon Mfg. Co.*, *supra*.

Beyond the question of adequacy of common law forms of action, it is as true in the field of securities law regulation as in other fields of primary federal concern that the substantive content of the rights and remedies provided should be uniform throughout the country. To permit varying doctrines of state law, substantive or procedural, to affect adversely the application of federal regulatory law, would be an impermissible interference with its effectiveness. As this Court held in *Sola Electric Co.* v. *Jefferson Electric Co.*, *supra*, the legal relations arising under such laws "must be deemed governed by federal law having its source in those statutes, rather than by local law." (317 U.S. at 176; citations omitted.)

A cause of action arising under a federal statute that is part of the body of law providing for national regulation of the securities industry is neither a traditional state law claim nor one in an area of basic state concern. Federal law is the appropriate law, and the federal courts are the proper forum.

VII.

Every Valid Policy Consideration That May Bear on This Case Supports Recognition of an Implied Right of Action Under the Advisers Act.

The Court of Appeals held in this case that a private right of action for injunctive relief and damages could be implied under the Advisers Act in favor of an appropriate plaintiff. The correctness of that holding is all that is before this Court. It warrants affirmance.

The interpretation, construction and enforcement of federal statutory law is, next to the interpretation, application and protection of the Constitution itself, the quintessential business of the federal courts. This should not need to be said; but the essence of petitioners' final plea for reversal of the Court of Appeals is that this and all similar cases should be barred from the federal courts; lest the courts be burdened with the task of applying and interpreting the statute, and setting the legal perimeters of such cases. (*Brief for Petitioners* at 28-29.)

It is difficult to conclude that any considerations of legal or practical policy justify, much less mandate, so gross a departure from the spirit expressed in the *Borak* case, where a unanimous Court agreed that it was "the duty of the courts to be alert," to effectuate the purposes of federal positive law, and to make meaningful the rights arising under that law. (377 U.S. at 433.)

There is nothing here to justify departure from these standards, or transgressing any limitations on private actions established by this Court. The threats to existing limitations on securities law actions; the danger of unlimited, open-ended suits; and the panoply of related

demons conjured by petitioners, are offered as an appeal to unreason.

In *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), this Court held that *scienter* was a necessary element of an action arising under Section 10(b) and Rule 10b-5. In so doing, it thus made applicable in all of the federal courts the existing rule in the Second Circuit. *See, e.g., Lanza* v. *Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973). Because the type of conduct prohibited by Section 206 of the Advisers Act is indistinguishable in this regard from that prohibited by Rule 10b-5, it is fair to presume that the federal courts (in giving proper scope to Section 206 actions) will be appropriately guided. Affirmance here does not erode, and will not cause other courts to erode, the holding in *Ernst & Ernst*.

The rest of petitioners' practical or policy arguments have still less bearing on this case. They constitute a recital of imagined perils growing out of the factual situation said to be presented in *Abrahamson*, in which this Court denied certiorari (436 U.S. 913 (1978)). The case at bar, since it arises out of the making and performance of an investment advisory agreement and transactions integrally related to the relationship between MTA, its adviser and its adviser's parent and affiliate, is a peculiar context in which to relitigate *Abrahamson*. In any event, the imagined perils are nonexistent in the Advisers Act context.

In *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), this Court confirmed the "purchaser-seller" requirement as an essential element in actions brought under Section 10(b) of the 1934 Act and Rule 10b-5. Again, this was the law in the Second Circuit, *Birnbaum* v. *Newport Steel Co.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), and the majority rule. *See generally*,

Jacobs, The Impact of Rule 10b-5, § 38.01 (1978 ed.). No such requirement should or can be superimposed on Section 206, which deals with the adviser-client relationship, and is not specifically directed toward purchase or sale transactions. But actions grounded in Section 206 have their own inherent limits, as defined by the bounds of the relationship they arise from.

In the *Blue Chip Stamps* case, the Court expressed concern that, but for the "purchaser-seller" requirement, an unlimited universe of putative plaintiffs who, having had no transactional or other relationship with putative defendants, would nonetheless would be able to maintain actions on the theory that they had refrained from entering into transactions because of representations or omissions chargeable to such defendants. Such claims might be unreasonably difficult to defend and expose defendants to unjustifiable risk. (421 U.S. at 754-755.)

That problem is neither presented nor suggested by the case at bar, or like cases. Only the known, limited class of persons who can assert claims in connection with the making or performance of an advisory contract, or a course of conduct in an advisory relationship, are eligible to sue under the terms of Section 206 of the Advisers Act. Petitioners are not faced with the problem of disproving "what a plaintiff says he would have done." *See Abrahamson* v. *Fleschner, supra*, 568 F.2d at 884 (Gurfein, J., concurring and dissenting). Outside of the precise context of *Blue Chip*, the fear is, in any event, lacking in reality. In those cases where a plaintiff's actual state of mind is part of his case, the defendant does not have to "disprove" it. This is elementary. If what is actually being expressed is a fear of the competence of triers of the facts, no evidence is offered for its validity. If the point is that some questions cannot be left to the unguided determination of such

triers, the courts have, without great difficulty, established guiding principles. *See TSC Industries* v. *Northway, Inc.*, 426 U.S. 438 (1976).

Eventually, petitioners fall back upon a series of unfounded assertions, with respect to the merit or lack of merit of other cases not before this Court. *Brief for Petitioners,* 30-31.) They offer the odd proposition that, since certain suits have been brought against investment advisers to real estate trusts, since a number of these have been settled, and since some have been dismissed or withdrawn, it follows that the settled cases were so terminated, for more than was warranted on their merits, due to defendants' amorphous fears. This chain of suppositious innuendo is said to constitute reason for reversal here. Quite the contrary. It should be disregarded because it is based upon asserted facts not of record, unverified and incapable of verification. The subjective and biased interpretation of the asserted data is supported by neither authority nor expertise. Lastly, as is so often the case, the only verifiable datum offered—that is, the only reported decision mentioned—is wrongly described and miscited.[35] The formulary protestations of corporate defendants are not data; nor are they a basis for making, or finding, correct rules of law.

As petitioners' argument draws to a close, its underlying theme is clarified. They ask this Court to disregard the

[35] That reported case, *Jones* v. *Equitable Life Assurance Society,* 409 F. Supp. 370 (S.D.N.Y. 1975), offered as an example of a settled case and, by innuendo, an unjustified settlement, was decided for defendants. (*Compare Brief for Petitioners,* 30 n. 54.) The case cited as *Cooper* v. *USF Investors,* U.S.D.C., S.D.N.Y., 73 Civ. 2769 (MP), is misleadingly described. Reference to the cited file shows that, under the title *Independence Mortgage Trust* v. *USF Investors Inc.*, that case was settled, after the trust, by its new board of trustees, had been consensually substituted as plaintiff, and after the bankruptcy of the advisory company's parent.

actualities of the case at bar and to abandon the age-old rule that it will decide only the case or controversy that is actually before it. Petitioners' thesis is that suits brought by private plaintiffs under the federal securities laws should be presumed unmeritorious, and an imposition; that the federal courts should find ways to deny access to the courts to such investors; and that this is more important than adherence to the orderly process of deciding litigation on the law and on the merits. Petitioners look with feigned horror on the prospect that courts may be called upon in the future to determine litigation testing the "meaning, application and outer limits" of the Advisers Act. (Brief for Petitioners, 32). How much wiser it would be, they say, to rule that, so far as the community of investors is concerned, the Act has no meaning, no application and no rights to limit.

The Court of Appeals here, and the courts that decided *Abrahamson* and *Wilson,* have by their acts already answered this appeal. They have carefully and precisely applied the law as expounded by this Court; and they have not found themselves burdened or oppressed by the need to adjudicate the claims presented.

Little more than fifteen years ago, in *Securities and Exchange Commission* v. *Capital Gains Research Bureau Inc.,* 375 U.S. 180 (1963), this Court manifested its understanding that federal regulation of the securities industry, at a level of stringency sufficient to create confidence in the integrity of the capital market, was an essential ingredient to the economic well-being of the nation. That is as true now as it was then.

The rights recognized by the courts below, and their enforcement in appropriate cases, will contribute to that goal.

CONCLUSION

Recognition of an implied right of action under the Advisers Act, whether equitable or legal in character, is appropriate and correct; is a continuance and confirmation of sound and tested principles of judicial decision; and follows from a correct analysis of each and all of the criteria established by this Court.

Respondent respectfully prays for an order of this Court affirming the decision and order of the Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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ADDENDUM

ADDENDUM

Section 206, Investment Advisers Act of 1940; 54 Stat. 852, as amended, 4 Stat. 887, 15 U.S.C. § 80b-6:

§ 80b-6. Prohibited transactions by investment advisers.

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transacton. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulatons define, and pre-

scribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Aug. 22, 1940, c. 686, Title II, § 206, 54 Stat. 852; Sept. 13, 1960, Pub.L. 86-750, §§ 8, 9, 74 Stat. 887.

Section 214, Investment Advisers Act of 1940; 54 Stat. 856, 15 U.S.C. § 80b-14:

§ 80b-14. Jurisdiction of offenses and suits.

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the

Commission in any proceeding under this subchapter brought by or against the Commission in any court.

Aug. 22, 1940, c. 686, Title II, § 214, 54 Stat. 856.

Section 215, Investment Advisers Act of 1940; 54 Stat. 856, 15 U.S.C. § 80b-15.

§ 80b-15. Validity of contracts

(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this subchapter or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision.

Aug. 22, 1940, c. 686, Title II, § 215, 54 Stat. 856.

FOR ARGUMENT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; AND MORTGAGE TRUST OF AMERICA,

Petitioners,

—v.—

HARRY LEWIS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

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Petitioners,

—v.—

HARRY LEWIS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

INTRODUCTION

This brief for petitioners is in reply to various arguments made by respondent, and includes comment on certain points in the *amicus* briefs filed by the Securities and Exchange Commission and by the plaintiffs in the *Sullivan* case.[1]

---

1. *Sullivan v. Chase Investment Services of Boston, Inc.*, U.S.D.C., N.D. Cal., No. C 76-1783 CBR.

ARGUMENT

There is no showing in any of the three briefs filed in support of respondent's position that "the creation by judicial interpretation of [an] implied cause of action is *necessary* to effectuate Congress' goals" in enacting the Advisers Act. *See, Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 26 (1977) (emphasis added).

The only departure from well-ploughed ground is respondent's repeated reference to the Securities Exchange Act of 1934 and Section 215(b) of the Advisers Act. Respondent's reliance on the 1934 Act and on Section 215(b) of the Advisers Act is not justified and should be rejected.

1. The History, Objectives, Application and Interpretation of the Advisers Act and of the 1934 Act Differ Significantly.

Section 215(b) of the Advisers Act provides in effect that contracts made or to be performed in violation of the Act "shall be void."[2] In reliance on the foregoing provision and on Section 29(b) of the 1934 Act,[3] respondent argues that the Advisers Act implies a private right of action for equitable relief and money damages. (*See*, Brief for Respondent ("Res. Brief") at 39-43.) Respondent's argument may be summarized as follows:

> —Section 215(b) of the Advisers Act is "utterly indistinguishable" from Section 29(b) of the Securities Exchange Act of 1934. (Res. Brief 40).
>
> —Section 29(b) of the 1934 Act has been interpreted as support for the implication of a private right of action under the 1934 Act. (Res. Brief 40-41).

2. 15 U.S.C. § 80b-15 (1971). The complete text of Section 215 of the Investment Advisers Act is set forth at page 3a of the *Addendum* to Brief for Respondent.

3. 15 U.S.C. § 78cc(b) (1971).

> —Therefore, Section 215(b) of the Advisers Act should be interpreted as support for a private right of action under the Advisers Act. (Res. Brief 40-41).

Respondent's argument does not bear the burden of analysis. It is based upon erroneous assumptions, the use of questionable authority, and disregard of the limitations on private actions recently recognized by this Court.

Those cases which rely upon Section 29(b) of the 1934 Act to imply a private right of action were interpreting the 1934 Act. This obvious fact has been overlooked by respondent in his effort to show that the "thrust" of Section 29(b) is the same as that of Section 215(b) of the Advisers Act. (Res. Brief 40). Respondent ignores the fact that the history, objectives, application and interpretation of the two acts differ significantly. Petitioners and respondent may dispute the intent and purpose of the Advisers Act.[4] But there can be no dispute that the intent and purpose of the Advisers Act is *not* the same as the intent and purpose of the 1934 Act. The Advisers Act was enacted to regulate and protect a small segment of the securities industry.[5] The 1934 Act was enacted to regulate the marketing of securities generally.[6] Using the 1934 Act to interpret the Advisers Act provokes more questions than answers.

4. *Compare* Brief for Petitioners at pages 7-28 *with* Brief for Respondent at pages 20-56.

5. *See*, H.R. Rep. 2639, 76th Cong., 3d Sess., 28 (1940). *See also*, Brief for Petitioners at pages 22-23.

6. The 1934 Act is aimed at "the full range of ingenious devices that might be used to manipulate securities prices." *Santa Fe Industries Inc. v. Green*, 430 U.S. 462, 477 (1977).

2. Since the Advisers Act and the 1934 Act Differ Significantly, Interpreting and Applying the Two Acts in the Same Manner Is Not Justified.

Relying on Section 29(b) of the 1934 Act, respondent proposes the wholesale adoption of 1934 Act principles in the interpretation and application of the Advisers Act. Respondent sidles past the well-recognized problems the federal courts would encounter in attempting to define a private right of action under the Advisers Act, including questions of standing, problems of causation and reliance, and questions of intent.[7]

The problem is illustrated in the brief filed by the Securities and Exchange Commission as *amicus curiae*. The SEC argues that Section 206 of the Advisers Act, which makes certain acts by advisers unlawful, "has its own limits on the scope of liability" and that the statute "effectively limits the number of potential plaintiffs and rules out unforeseen liabilities to the general public." *See,* Brief for the Securities and Exchange Commission as Amicus Curiae ("SEC Brief") at page 44. In fact, Section 206 of the Advisers Act makes unlawful certain acts by investment advisers against a client *"or prospective client."*[8] Section 206 does *not* presuppose "the existence of a relationship of financial trust or reliance . . ." (SEC Brief 44). Section 206 does *not* limit plaintiffs to a "determinable class." (SEC Brief 44). Contrary to respondent's assurances, Section 206 does *not* limit private actions to a "limited class of persons

7. *See,* Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich. L. Rev. 308, 331-338 (1975); Note, *Securities Law—Investment Adviser Fraud—A Private Damages Remedy Is Implied Under Section 206 of the Investment Advisers Act of 1940,* 30 Vand. L. Rev. 905, 920 (1977). *See also, Abrahamson v. Fleschner,* 568 F.2d 862, 884-887 (2d Cir. 1977) (Gurfein, J., concurring and dissenting).

8. 15 U.S.C. § 80b-6 (1971) (emphasis added).

who can assert claims in connection with the making or performance of an advisory contract, or a course of conduct in an advisory relationship . . ." (Res. Brief 59).

Interpreting Section 206 of the Advisers Act to allow a private right of action would destroy the purchase-or-sale limitation on actions under Section 10(b) of the 1934 Act recently recognized by this Court. *See, Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 733, 749 (1975). By definition, a "prospective client" of an investment adviser has neither purchased nor sold securities on the advice of the adviser. Allowing a "prospective client" to maintain an action against a "prospective" investment adviser would raise the same "conjectural as well as subjective issues" Mr. Justice Powell noted in *Blue Chip Stamps, supra* at 758 n. 2 (Powell, J., concurring).

3. There Is an Important Distinction Between Section 215(b) of the Advisers Act and Section 29(b) of the 1934 Act.

There are *no* cases holding that Section 215(b) of the Advisers Act implies a private right of action. Respondents recognize this fact, but argue that Section 215(b) of the Advisers Act is "utterly indistinguishable" from Section 29(b) of the 1934 Act. Section 29(b) is sometimes cited as a basis for implying a private right of action under Section 10(b) of the 1934 Act.[9] In fact, there is an important distinction between Section 215(b) of the Advisers Act and Section 29(b) of the 1934 Act. Section 29(b) was amended in 1938 to add a statute of limitations for certain violations

9. *See, Fischman v. Raytheon Mfg. Co.,* 188 F.2d 783, 787 n.4 (2d Cir. 1951); *Kardon v. National Gypsum Co.,* 49 F.Supp. 512, 514 (E.D. Pa. 1946).

of the 1934 Act.[10] Section 215(b) of the Advisers Act contains no such provision.

The distinction is significant.

The existence of a statute of limitations in Section 29(b) of the Securities Exchange Act is the *very reason* various courts have interpreted Section 29(b) as affording a private right of action. *See, Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 787 n. 4 (2d Cir. 1951); *Kardon v. National Gypsum Co.*, 69 F.Supp. 512, 514 (E.D. Pa. 1946). As explained in *Kardon*, the statute of limitations amendment to Section 29(b) "clearly contemplates that Congress meant the original statute to be interpreted as providing for civil suits under it." *Kardon v. National Gypsum Co., supra* at 514.[11]

The addition of a statute of limitations to Section 29(b) of the 1934 Act has been interpreted as support for a private right of action. *Fischman v. Raytheon Mfg. Co., supra* at 787 n. 4; *Kardon v. National Gypsum Co., supra* at 514. But unlike Section 29(b), Section 215(b) of the Advisers Act has *not* been amended and does *not* contain a statute of limitations. By analogous reasoning, one would conclude that Congress did not regard Section 215(b) of the Advisers Act as the basis for private action.[12]

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10. *See*, Act of June 25, 1938, c. 677, § 3, 52 Stat. 1076 (*amending* 15 U.S.C. § 78cc (1971)).

11. *See also, Geismar v. Bond & Goodwin, Inc.*, 40 F.Supp. 876, 878 (S.D.N.Y. 1941).

12. Reliance on Section 215(b) of the Advisers Act as the basis for implying a private remedy has been called "inconclusive" and "is arguably offset by indications in the Act's legislative history of congressional reluctance to 'over-regulate' the advisory industry, which suggest a desire to minimize the potential liability of advisers." Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 Mich. L. Rev. 308, 319-320 (1975) (footnote omitted).

4. Various Considerations Belie Respondent's Argument That Section 215(b) of the Advisers Act Implies a Private Right of Action.

The following considerations are pertinent in evaluating respondent's argument that Section 215(b) of the Advisers Act implies a private right of action:

(1) There is nothing in the legislative history of Section 215(b) of the Advisers Act to support the conclusion that it creates a private right of action—legal or equitable.[13] Respondent offers no citations to the contrary.

(2) Professor Loss notes that Section 29(b) of the 1934 Act implies a private remedy "only when plaintiff and defendant are in privity of contract, or perhaps when the plaintiff can work out a third-party beneficiary relationship." 3 Loss, Securities Regulation 1759 (2d ed. 1961). The Advisers Act does not require privity of contract or a third-party beneficiary relationship. As noted above, Section 206 makes unlawful certain acts by an investment adviser against a client or "prospective client." A "prospective client" by definition is *not* in privity of contract with the adviser, nor is he a third-party beneficiary of the adviser's services.

(3) The inclusion of "prospective client" in the coverage of Section 206 of the Advisers Act was almost certainly intended to give the Securities and Exchange Commission wide latitude in the use of the Act's enforcement powers. The inclusion of "prospective client" in the coverage of Section 206 complements Section 209,

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13. *See*, Brief for Respondent at page 30, where respondent acknowledges that there is no evidence Congress ever expressly considered the problem of private actions when it enacted the Advisers Act. *See also*, Brief for Petitioners at pages 7-25.

which empowers the Commission to seek an injunction against persons "about to engage in" or "aiding, abetting, counseling, commanding, inducing, or procuring" a violation of the Act. *See,* 15 U.S.C. § 80b-9 (1971). The inclusion of "prospective client" in Section 206 is consistent with enforcement of the Advisers Act by the Commission—and wholly inconsistent with the limitations on private securities law actions recently recognized by this Court. A class of "prospective client" plaintiffs has no practical limits.

(4) Rather than creating a private implied right to *affirmative* action, Section 215(b) may be read as establishing a *defense* to an action based on an investment adviser contract. This interpretation is suggested by the fact that Section 215(b) of the Advisers Act was apparently based on state blue sky laws,[14] which in turn are based on the familiar common law principle that illegal or unlawful contracts will not be enforced.[15]

(5) Implying a private right of action for rescission, as respondent requests, would open the door to the award of money damages.

Respondent appears to recognize that it would be difficult for this Court to imply a private right of action for money damages under the Advisers Act (*See,* Res. Brief 39-43). To salvage his money damage claims, respondent argues

14. *See,* 3 Loss, Securities Regulation 1758-1759 (2d ed. 1961), where Professor Loss states that Section 215(b) of the Advisers Act and similar provisions in the other federal securities laws "have ample precedent in the blue sky laws."

15. *See,* 17 C.J.S. Contracts, § 272, 1188-1197 (1963); 14 Cal. Jur.3d, Contracts § 140, 368-370 (1974); *Lee On v. Long,* 37 Cal.2d 499, 502-503, 234 P.2d 9 (1951); *Franklin v. Nat C. Goldstone Agency,* 33 Cal.2d 628, 632, 204 P.2d 37 (1949).

that as part of his rescission action, the District Court should be empowered to "dispose of all claims, even if the only remedy found proper is an award of damages on the legal claims." (Res. Brief 41). Respondent's proposal would undermine existing distinctions between claims for equitable relief and actions for money damages, and is another reason why Section 215(b) should not be interpreted as creating a private cause of action—legal or equitable.

5. Congress Is in the Best Position to Create and Limit a Private Right of Action Under the Advisers Act.

Respondents would have the federal courts interpret and limit the private right of action proposed under the Advisers Act. Interpreting statutes may well be a "quintessential business of the federal courts". (Res. Brief 57). But we think it evident that creating and limiting private remedies under the federal securities laws is a task best left to Congress.

In 1970 Congress amended both the Investment Company Act and the Advisers Act.[16] Congress added an express private right of action to the Investment Company Act, but added *no* such right to the Advisers Act.

The amendments to the Investment Company Act were carefully drawn and cover virtually all of the questions that would otherwise be left open to litigation. Among other provisions, the amendments to the Investment Company Act creating an express right of action (1) impose a carefully-defined fiduciary duty on certain investment advisers; (2) specify and limit the persons or entities who may be defendants; (3) specify and limit the persons or entities who may bring the action; (4) allocate the burden of proof

16. Public Law No. 91-547, 84 Stat. 1413 (1970).

and establish evidentiary standards; and (5) limit the nature and extent of the damages which may be recovered. *See,* 15 U.S.C. § 80a-35 (1971).

No such rights and limitations have ever been a part of the Advisers Act.

Congress has shown it will create private rights of action as necessary. When it creates a private right of action, Congress has devoted careful attention to the issues that would otherwise plague the federal courts if the right arose from judicial implication. Congress has created express private rights of action as necessary. Congress is in the best position to define and limit the remedies it creates. *Accord, Abrahamson v. Fleschner,* 568 F.2d 862, 883-884 (2d Cir. 1977) (Gurfein, J., concurring and dissenting).

6. The Investment Advisers Act Does Not Apply to Petitioners.

Finally, we respectfully direct attention to a procedural aspect of this case which has been the subject of argument to this Court by the plaintiffs in the *Sullivan* case as *amici curiae.*[17]

When petitioners asked the District Court to dismiss this case, they argued (1) that neither the Investment Company Act nor the Investment Advisers Act applies to petitioners; (2) that petitioners Transamerica Mortgage Advisors, Inc. (TAMA), and Transamerica Corporation

17. *See,* Motion for Leave to File Brief Amicus Curiae and Brief Amicus Curiae in Support of Respondent, dated January 31, 1979, submitted by the plaintiffs in *Sullivan v. Chase Investment Services of Boston, Inc.,* U.S.D.C., N.D. Cal., No. C 76-1783 CBR. The *Sullivan* case is reported at *Sullivan v. Chase Investment Services of Boston, Inc.,* 434 F.Supp. 171 (N.D. Cal. 1977) (implying a private right of action under the Investment Advisers Act); and at *Sullivan v. Chase Investment Services of Boston, Inc.,* 79 F.R.D. 246 (N.D. Cal. 1978) (certifying a class action).

are exempt from registration in any event; (3) that respondent did not excuse his failure to make demand on the trustees of Mortgage Trust of America; and (4) that the Advisers Act does not afford a private right of action.[18]

The District Court remarked that all of petitioners' arguments had "substantial merit," but found it unnecessary to rule on all of the arguments since the Advisers Act does not afford a private right of action.[19]

On appeal, petitioners again urged consideration of the arguments that the Advisers Act does not apply to the petitioners, and that the respondent had not excused his failure to make demand on the trustees of Mortgage Trust of America. (A. 30). The Court of Appeals declined to consider those arguments, and said that since the District Court "did not adjudicate those issues . . . we decline to now do so." (A. 30) (citations omitted).[20]

18. Petitioners explained to the District Court (R. 246-253) and to the Court of Appeal (A. 30) that Mortgage Trust of America is a mortgage lender, and that since mortgages are not "securities" within the meaning of the federal securities laws, neither the Investment Company Act nor the Advisers Act applies. *See, United Housing Foundation v. Forman,* 421 U.S. 837 (1975).

19. "I think there is substantial merit to a number of various other contentions that the [petitioners] have made here but I find it unnecessary to reach any of those if I can't get over the initial jurisdictional requisite. So my present view is that the Investment Advisers Act simply does not provide [respondent] a private cause of action. There is no Federal jurisdiction and that this complaint should be and must be dismissed." (Reporter's Transcript 10, included as Volume III of the record transmitted to this Court by the Court of Appeals on January 10, 1979.)

20. In support of their request that the Court of Appeals rule on the alternate arguments presented to the District Court, petitioners cited various authorities, including *Helvering v. Gowran,* 302 U.S. 238 (1937), where Mr. Justice Brandeis commented that in the review of judicial proceedings "the rule is settled that, if the decision below is correct, it must be affirmed, although the lower court relied upon a wrong ground or gave a wrong reason." *Id.* at 245.

In an *amicus* brief filed in support of the respondent, the plaintiffs in *Sullivan v. Chase Investment Services of Boston, Inc.*, U.S.D.C., N.D. Cal., No. C 76-1783 CBR, state that this case "*does not* present the type of fraudulent conduct which the Investment Advisers Act was expressly established to prevent . . ." (Sullivan Brief 7) (emphasis in original). The plaintiffs in *Sullivan* further state that it is "questionable" whether TAMA "is in fact an investment adviser at all within the meaning of the Advisers Act . . ." or whether TAMA "rendered advice with respect to a 'security' as that term is defined by the Advisers Act . . ." (Sullivan Brief 8).

We agree. But since the courts below declined to consider petitioners' other arguments, we are before this Court on the only decided issue, namely, whether the Advisers Act affords a private right of action.

We are mindful of this Court's reluctance to decide issues that have been passed over by the lower courts. *See, United States v. United Continental Tuna Corp.*, 425 U.S. 164, 181-182 (1976); *Wood v. Strickland*, 420 U.S. 308, 326-327 (1975); *and see*, 17 Wright, Miller & Cooper, Federal Practice and Procedure § 4036, 28 (1978). As Mr. Justice Harlan once explained, where issues have not been considered by the Court of Appeals, "this Court will not ordinarily consider them." *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 147 n. 2 (1970) (citations omitted).

At the same time, we are aware of circumstances where this Court has decided issues that were not decided below. Reasons given include the desire to terminate lengthy proceedings,[21] the findings of a preferred ground for disposition,[22] or the presence of a clear issue.[23] In *Fry v. United States*, 421 U.S. 542 (1975), for example, this Court dealt with a statutory issue first raised in *amicus* briefs "rather than decide a constitutional question when there may be doubt whether there is any statutory basis for it, . . ." *Id.* at 545 n. 5.

21. *See, e.g., In re Permian Basin Area Rate Cases*, 390 U.S. 747, 823-824 (1968); *Griffin v. County School Board of Prince Edward County*, 375 U.S. 391, 392 (1964).

We continue to believe that neither the Investment Company Act nor the Advisers Act applies to the petitioners here. The mortgage loans involved in this case are not "securities" within the meaning of the federal securities laws, and TAMA is exempt from registration under the Advisers Act.[24]

Accordingly, the Court may wish to consider the issues presented to the District Court and Court of Appeals, and petitioners would welcome an opportunity to further brief and argue those issues as may be appropriate.[25]

22. *See, Ohio Bureau of Employment Services v. Hodory*, 431 U.S. 471, 477 (1977); *See also, Boynton v. Virginia*, 364 U.S. 454, 457 (1960).

23. *See, Levin v. Mississippi River Fuel Corp.*, 386 U.S. 162 (1967) where Mr. Justice Clark said that the "point is so clear that we see no occasion for remanding the issue to the Court of Appeals for its consideration of the point, even though it be assumed that its opinion does not decide it. Effective judicial administration requires that we dispose of the matter here." *Id.* at 169-70.

24. Respondent concedes and agrees that Morgage Trust of America's investments are limited to "real estate mortgages of various types, other real estate loans and some equity interests in real estate . . ." (Res. Brief 3). Respondent further concedes and agrees that the "adviser" involved in this case, TAMA, has only one client —Mortgage Trust of America. (Res. Brief 3). The Advisers Act does not require registration of an investment adviser "who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company . . ." 15 U.S.C. § 80b-3(b)(3) (1971).

25. *See generally*, Stern and Gressman, Supreme Court Practice § 6.27, 456-463 (5th ed. 1978).

CONCLUSION

For the reasons set forth in their opening brief and in the foregoing reply, petitioners respectfully pray for an order of this Court *reversing* the decision of the court below.

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OCTOBER TERM, 1978

TRANSAMERICA MORTGAGE ADVISERS, INC., ET AL., PETITIONERS

v.

HARRY LEWIS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-1645

TRANSAMERICA MORTGAGE ADVISERS, INC., ET AL., PETITIONERS

v.

HARRY LEWIS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

QUESTION PRESENTED

Whether there is a private right of action under Section 206 of the Investment Advisers Act of 1940.

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission is responsible for the administration and enforcement of

the Investment Advisers Act of 1940, 15 U.S.C. 80b-1 *et seq.* The Commission's enforcement proceedings seeking to enjoin fraudulent practices of investment advisers are ordinarily "mild prophylactic" measures (*SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 193 (1963)) that generally do not provide redress to clients of advisers who are injured by fraud. The Commission therefore believes that a private right of action for damages and injunctive relief under Section 206 of the Act, 15 U.S.C. 80b-6, is necessary to protect such clients and to make effective the "federal fiduciary standards" (*Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 471 n.11 (1977)) prescribed by Congress. Here, as elsewhere, private redress would serve as a "necessary supplement" to the Commission's own enforcement proceedings. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 382 (1970); *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964).

STATEMENT

1. Respondent, a shareholder of petitioner Mortgage Trust of America ("Trust"), filed this suit in April 1973. The suit was brought as a derivative action on behalf of the Trust and as a class action on behalf of similarly situated shareholders. The complaint alleges that the Trust is a real estate investment trust within the meaning of Sections 856-858 of the Internal Revenue Code of 1954. The Trust was established to invest in a diversified portfolio of real estate mortgages, including construction and development mortgages, permanent first and junior mort-

gages, and certain equity interests in real estate (A. 4). At the time the action was commenced, approximately 3,382,000 shares of beneficial interest in the Trust were outstanding (A. 5). Petitioner Transamerica Mortgage Advisors, Inc. ("TAMA") is the investment adviser to the Trust and administers its day-to-day operations; the Trust is and always has been TAMA's only client (Pet. Br. 3). Petitioner Transamerica Corporation is the sponsor of the Trust and the parent of petitioner Transamerica Land Capital Inc. ("Land Capital"). Land Capital is the parent of TAMA, through a wholly-owned subsidiary, Transamerica Mortgage Company (Pet. Br. 3), which sold the Trust its original investment portfolio of mortgages (A. 29). The individual petitioners are trustees of the Trust (Pet. Br. 3). Several of these trustees have been affiliated with Transamerica Corporation, TAMA, or other subsidiaries of Transamerica Corporation (A. 6-7).

2. The complaint sets forth six claims. The first and fourth claims allege that the advisory contract between TAMA and the Trust is unlawful because TAMA and Transamerica Corporation have never registered under the Investment Advisers Act (A. 9). The complaint also alleges that TAMA and Transamerica Corporation have received grossly excessive compensation under the contract (A. 10). The second and fifth claims allege that TAMA and Transamerica Corporation caused the Trust to purchase securities from Land Capital. Those securities purchases are alleged to be the result of self-dealing and breach of

fiduciary duty, causing financial injury to the Trust (A. 14-16). The third and sixth claims allege that TAMA and Transamerica Corporation have withheld profitable investment opportunities from the Trust and have appropriated those opportunities for the benefit of other Transamerica affiliates (A. 17-18). The first three claims are stated derivatively on behalf of the Trust and against those responsible for the allegedly improper conduct. The other claims are pleaded on behalf of the class of the Trust's shareholders.

The complaint seeks injunctive relief to restrain further performance of the advisory contract; rescission of the advisory contract; restitution of fees and other consideration paid by the Trust; an accounting of illegal profits; and an award of damages (A. 20-21).

3. In March 1974 petitioners moved to dismiss the complaint. The district court granted the motion, concluding that "Section 206 * * * affords no private right of action" (A. 25). The court of appeals reversed, holding that "implication of a private right of action for injunctive relief and damages under the Advisers Act in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation" (A. 31). The court pointed out that the Fifth and Second Circuits have held that such actions may be maintained. See *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), petion for cert. pending, No. 77-1717; *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), cert. denied,

436 U.S. 913 (1978). Without repeating the discussion contained in *Abrahamson* and *Wilson*, the court of appeals in this case adopted the rationale of the majority in both of those cases.[1] Judge Wallace, in dissent, adopted the position of Judge Gurfein, who dissented in *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 879-887.

Although petitioners argued that they were not subject to the provisions of the Investment Advisers Act, that respondent's class action claims were improper, and that a derivative action could not be maintained without a prior demand on the trustees,

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[1] A number of district courts previously had found that private plaintiffs may sue to enforce Section 206 of the Investment Advisers Act. See *Sullivan* v. *Chase Investment Services of Boston, Inc.*, 434 F. Supp. 171, 179 (N.D. Cal. 1977); *Fund of Funds, Ltd.* v. *Vesco*, [1976-1977] CCH Fed. Sec. L. Rep. ¶ 95,644 at 90,197-90,198 (S.D. N.Y. 1976); *Angelakis* v. *Churchill Management Corp.*, [1975-1976] CCH Fed. Sec. L. Rep. ¶ 95,285 at 98,463-98,464 (N.D. Cal. 1975); *Jones* v. *Equitable Life Assurance Society*, 409 F. Supp. 370, 373 (S.D. N.Y. 1975); *Bolger* v. *Laventhol, Kekstein, Horwarth & Horwarth*, 381 F. Supp. 260, 265, 268 (S.D. N.Y. 1974). See also *Kauffman* v. *Dreyfus Fund, Inc.*, 434 F.2d 727, 732-734 (3d Cir. 1970); *Gross* v. *Diversified Mortgage Investors*, 431 F. Supp. 1080, 1094-1095 (S.D. N.Y. 1977); *Fox* v. *Prudent Resources Trust*, 382 F. Supp. 81, 90-92 (E.D. Pa. 1974); *Young* v. *Seaboard Corp.*, 360 F. Supp. 490, 497 (D. Utah 1973); *Courtland* v. *Walston & Co., Inc.*, 340 F. Supp. 1076, 1082-1085 (S.D. N.Y. 1972). Two district courts have held that private remedies do not exist. See *Greenspan* v. *Del Toro*, [1975-1976] CCH Fed. Sec. L. Rep. ¶ 95,488 (S.D. Fla. 1974); *Gammage* v. *Roberts, Scott & Co., Inc.*, [1974-1975] CCH Fed. Sec. L. Rep. ¶ 94,761 (S.D. Cal. 1974). Those two decisions are of little effect because they are from circuits (the Fifth and Ninth) in which appellate opinions thereafter allowed private actions.

the court of appeals declined to consider those issues because the district court had not decided them (A. 30).

SUMMARY OF ARGUMENT

A private right of action for damages in favor of defrauded clients of an investment adviser is necessary to effectuate Congress' purpose in enacting Section 206 of the Investment Advisers Act, 15 U.S.C. 80b-6.

1. Respondent, the other shareholders and the Trust itself are among the class of persons for whose "especial benefit" (*Cort* v. *Ash*, 422 U.S. 66, 78 (1975)) the antifraud provision was enacted. Section 206, 15 U.S.C. 80b-6, prohibits fraud involving "any client" of an investment adviser. Congress sought to protect such clients "against malpractices by persons paid for advising others about securities." S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960). The decisions of this Court recognize that purpose. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-201 (1963); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 471 n.11 (1977).

2. Although the Investment Advisers Act does not explicitly authorize private suits, there is no indication that Congress intended to foreclose private relief. The omission of language expressly authorizing private actions is common to many antifraud provisions in the securities laws, yet there was unquestionably a congressional desire that remedies be available to eliminate fraudulent practices and to protect the

interests of clients of investment advisers. Congress has expressly provided that contracts and transactions in violation of the Act are void (Section 215, 15 U.S.C. 80b-15) and, as the court observed in the seminal decision with respect to implied remedies under Section 10(b) of the Securities Exchange Act, *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946), "a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it." See also *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 735 (1975).

3. A private right of action for damages is consistent with the purpose of Section 206. Private remedies would deter fraud and compensate injured clients. Such remedies also would be consistent with this Court's holding that the Act should be interpreted "not technically and restrictively, but flexibly to effectuate its remedial purposes." *SEC* v. *Capital Gains Research Bureau, Inc., supra*, 375 U.S. at 195.

A private remedy here would not conflict with public enforcement of the statute. To the contrary, "congressional purposes are likely to be undermined absent private enforcement" (*Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25 (1977)). The Commission does not have the resources needed to police this industry, and injunctions obtained by the Commission are inadequate to protect the economic interests of defrauded clients. A private right of action is necessary to achieve the remedial purposes of Section 206, just as a private right of action is neces-

sary to achieve the purposes of Section 14(a) (see *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 431-435 (1964)) and Section 10(b) of the Securities Exchange Act of 1934 (see *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 730).

4. Congress' creation of a national system of regulation, and its intention "to establish federal fiduciary standards for investment advisers" (*Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11), demonstrate the inappropriateness of relying on state law to redress private losses of the kind involved here. The need to develop uniform federal standards, and to require investment advisers to conduct their business in compliance with the policies of Congress (*SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 186-201), weighs heavily against reliance on state law principles. At the time of enactment of the statute, Congress emphasized "that the solution of the problems and abuses of investment advisory services * * * cannot be effected without Federal legislation." S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940). Because the right asserted is "federal" in nature (*J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 434), "there is redress" in federal court "whatever might be available as a remedy under state law." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971).

5. A private remedy for violation of the antifraud provision of the Investment Advisers Act is consistent with this Court's decision in *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*. Unlike the situation in

Blue Chip Stamps, where the plaintiff allegedly refrained from purchasing securities in reliance on false statements, a defrauded client is more than a mere "bystander" on the periphery of the securities markets; a "privity of dealing or even personal contact between potential defendant and potential plaintiff" is the rule, rather than the exception, in litigation under the Investment Advisers Act. *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 745, 747. Thus, although Section 206 of the Investment Advisers Act does not contain a requirement that the fraud complained of be in connection with a purchase or sale of a security, the plaintiff class is limited to defrauded clients of the defendant adviser. Where the adviser engages in fraudulent practices that injure this class of beneficiaries, private rights of action may be recognized without danger of "liability in an indeterminate amount for an indeterminate time to an indeterminate class." 421 U.S. at 748.

ARGUMENT

A DEFRAUDED CLIENT OF AN INVESTMENT ADVISER MAY BRING SUIT UNDER SECTION 206 OF THE INVESTMENT ADVISERS ACT OF 1940

"[D]isregard of the command of [a] statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied * * *." *Texas & Pacific Ry.* v. *Rigsby*, 241 U.S. 33, 39 (1916). See also

Tunstall v. *Brotherhood of Locomotive Firemen & Enginemen*, 323 U.S. 210, 213 (1944). These and many other decisions establish that courts ordinarily should grant remedies to private plaintiffs where "necessary to effectuate the congressional policy underpinning the substantive provisions of the statute." See *Bivens* v. *Six Unknown Named Agents*, 403 U.S. 388, 402 (1971) (Harlan, J., concurring).

This Court has repeatedly held that private persons may recover damages or obtain injunctions when they have been injured by violations of the provisions of the federal securities laws that were designed to protect persons situated similarly to the plaintiffs. See *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 433 ("it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose"); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 381-389 (1970); and *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 444 (1976) (recognizing implied rights of action under Section 14(a) of the Securities Exchange Act of 1934). See also *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 150-157 (1972) (recognizing implied rights of action under Section 10(b) of the Securities Exchange Act).[2]

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[2] Private rights of action have been recognized by the federal courts under the securities laws for more than thirty years. See *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512

Recent decisions of this Court have specified the considerations that govern whether courts should recognize a private right of action when the statute creating the substantive right is silent. See *Cort* v. *Ash*, 422 U.S. 66, 78 (1975) (citations omitted; emphasis by the Court):

> First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted"—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

This four-part test was applied by the Court in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), to determine whether a defeated tender-offerer could invoke an implied right of action under Section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(e).[3]

(E.D. Pa. 1946), referred to by this Court as "the seminal decision" in *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 730. See also *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2d Cir. 1951); *Goldstein* v. *Groesbeck*, 142 F.2d 422, 427 (2d Cir.), cert. denied, 323 U.S. 737 (1944).

[3] This Court concluded that a defeated tender-offeror should not have a private remedy because the tender-offeror was not the special beneficiary of that statute. *Piper* did not, however, rule out the possibility that a private action could be invoked

The Commission believes that, under the analysis set forth in *Piper* and *Cort*, private parties may obtain judicial relief for violations of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6, and that clients of investment advisers are appropriate parties to vindicate these rights.[4]

A. The Trust And Its Shareholders Are Members Of The Class For Whose Especial Benefit The Investment Advisers Act Was Enacted

The literal text of Section 206, 15 U.S.C. 80b-6, demonstrates that its special beneficiaries are clients

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by "shareholder-offerees" (see 430 U.S. at 38-39 & n.25). Moreover, the Court reaffirmed the basic principle "that, where congressional purposes are likely to be undermined absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute." *Id.* at 25. See also *Regents of the University of California* v. *Bakke*, No. 76-811 (June 28, 1978), slip op. 13-14 n.28 (Stevens, J., concurring and dissenting).

[4] A number of cases that the Court will consider this Term present related questions concerning implied private remedies. See *Chrysler Corp.* v. *Brown*, No. 77-922, argued Nov. 8, 1978; *Cannon* v. *University of Chicago*, No. 77-926, argued Jan. 9, 1979; *Touche Ross & Co.* v. *Redington*, No. 78-309, cert. granted (Nov. 27, 1978); *Davis* v. *Passman*, No. 78-5072, cert. granted (Oct. 30, 1978); *Southeastern Community College* v. *Davis*, No. 78-711, cert. granted (Jan. 8, 1979). The government's briefs in *Chrysler* and *Cannon* employ the same method of analysis that is employed in this brief. (The United States did not file a brief in *Passman* and is considering whether to participate in *Touche Ross* and *Southeastern Community College*.)

of investment advisers.[5] The statute unambiguously prohibits frauds and courses of business that operate as frauds upon clients. This Court's decisions also emphasize that the purpose of Section 206 is to protect such clients from fraud and breaches of fiduciary duty. See *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 186-195; *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11.

At the time of the Act's passage, Congress recognized the importance of investment advisers and the necessity of protecting their clients from misfeasance. See S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940)

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[5] In pertinent part, Section 206 provides:

> It shall be unlawful for any investment adviser * * * directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
>
> (3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. * * *
>
> (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. * * *

Section 206(4) was added to the statute in 1960. 74 Stat. 887. At that time Congress also extended the provisions of Section 206 to all investment advisers, whether or not such advisers were required to register under Section 203 of the Act. *Ibid.* Thus, the provisions of Section 206 apply to TAMA whether or not it is required to register, if it is an investment adviser (a question which, as noted, was not decided by the court below).

(stressing "the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors"); H.R. Rep. No. 2639, 76th Cong., 3d Sess. 28 (1940) (pointing out the need to protect clients "from the frauds and misrepresentations of unscrupulous tipsters and touts"); S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960) (the purpose of the statute is to prevent "malpractices by persons paid for advising others about securities"). See also SEC, Report on Investment Trusts and Investment Companies, (Investment Counsel and Investment Advisory Services), H.R. Doc. No. 477, 76th Cong., 2d Sess. 27-30 (1939). Thus, just as purchasers and sellers of securities are the special beneficiaries of Section 10(b), 15 U.S.C. 78j(b), and shareholder-recipients of proxy solicitations are the special beneficiaries of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a), an adviser's clients receive the special protections of Section 206 of the Investment Advisers Act. See *Abrahamson* v. *Fleschner*, 568 F.2d 862, 873 (2d Cir. 1977), cert. denied, 436 U.S. 913 (1978); *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235, 1240-1241 (5th Cir. 1978), petition for cert. pending, No. 77-1717.[6]

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[6] The Investment Advisers Act gives legal protection to the sensitive fiduciary relationship (*SEC* v. *Capital Gains Research Bureau, Inc., supra*, 375 U.S. at 191) that exists between an investment adviser and its clients. The Act "recognizes the personalized character of the services of investment advisers and especial care has been taken in the drafting of

B. There Is No Indication That Congress Intended To Foreclose Private Remedies

1. It is inherent in "implied cause of action" cases, such as the present one, that Congress was silent on the availability of private relief. The silence usually carries over to any jurisdictional statute that may accompany the substantive legislation in question. Thus jurisdiction over implied private rights of action often is supplied by 28 U.S.C. 1331, the general federal question jurisdiction statute. Things have been otherwise in most securities cases, because many securities laws contain jurisdictional provisions granting authority to decide actions at law. Section 214 of the Investment Advisers Act, 15 U.S.C. 80b-14, the provision that confers jurisdiction on the district courts to adjudicate claims of statutory violations and enjoin wrongdoing, differs from comparable provisions of the other securities laws because it omits reference to "actions at law."[7] Judge Gurfein, dissenting in

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the bill to respect this relationship." H.R. Rep. No. 2639, *supra* at 28. But Section 206 protects persons whose funds are managed on a collective basis as well as those persons who deal with their advisers on an individual basis. See S. Rep. No. 1775, *supra*, at 21 ("[T]he solution of the problems and abuses of investment advisory services—individuals and companies which either handle pools of liquid funds of the public or give advice with respect to security transactions—cannot be effected without Federal legislation"). The Trust in this case, which respondent seeks to represent derivatively, is a vehicle for the collective management of its shareholders' investments, and the protections of the Act extend to the shareholders themselves as well as the Trust.

[7] Section 214 of the Investment Advisers Act, 15 U.S.C. 80b-14, provides in relevant part:

> The district courts of the United States * * * shall have jurisdiction of violations of this subchapter or the rules,

Abrahamson v. *Fleschner*, *supra*, 568 F.2d at 881, cited this as evidence of congressional intent to foreclose damages actions under the Investment Advisers Act.[8] But the legislative history offers no support for the view that Congress omitted the "actions at law" phraseology in order to preclude private damages suits. If any inference can be drawn from the legislative history, it is that Congress did not focus on the issue of private remedies. See *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 875; *Wilson* v. *First Houston Investment Corp.*, *supra*, 566 F.2d at 1241-1242. See also *Cort* v. *Ash*, *supra*, 422 U.S. at 82-84; Comment, *Private Rights of Action under Amtrak and Ash*, 123 U. Pa. L. Rev. 1392, 1412 (1975).

Congress considered the Investment Advisers Act and the Investment Company Act of 1940 in tandem. The Investment Company Act was Title I, and the Investment Advisers Act Title II, of each of the bills

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regulations, or orders thereunder, and concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder.

Compare Section 22(a) of the Securities Act of 1933, 15 U.S.C. 77v(a); Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78aa; Section 25 of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79y; Section 322(b) of the Trust Indenture Act of 1939, 15 U.S.C. 77vvv(b); and Section 44 of the Investment Company Act of 1940, 15 U.S.C. 80a-43.

[8] Judge Wallace, dissenting in the instant case, adopted Judge Gurfein's views (A. 32).

introduced in Congress.[9] The jurisdictional provision in Title II of the original bill (which ultimately became Section 214 of the Investment Advisers Act), incorporated by reference the jurisdictional provision contained in Title I. See S. 3580, 75th Cong., 3d Sess. Section 203 (1940); H.R. 8935, 76th Cong., 3d Sess. Section 203 (1940). The jurisdictional provision in Title I, in turn, incorporated by reference Section 25 of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79y, which included the "actions at law" phraseology. See S. 3580, 76th Cong., 3d Sess. Section 40(a) (1940); H.R. 8935, 76th Cong., 3d Sess. Section 40(a) (1940).

After the hearings on the bill in the Senate, but before the hearings in the House, representatives of the investment advisory industry and the staff of the Commission met to discuss the bill. See S. Rep. No. 1775, *supra*, at 1. Judge Gurfein's dissenting opinion in *Abrahamson* points to these meetings and the resulting "compromise" that arose as an indication that the Act should be read more narrowly than other federal securities laws. *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 880. But the legislative history shows that no compromise affected the prohibition against fraud. As this Court has pointed out, the broad antifraud provision "remained in the bill from beginning to end." *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 191.

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[9] Although several versions of the Investment Advisers Act were proposed, the language in the House and Senate bills was identical at each stage.

Consideration of the relationship among Congress, the Commission and industry representatives in 1940 is useful in determining the nature of the compromises that were struck. In addition to questioning the necessity for federal regulation (*Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 745-746, 749-751 (1940) ("*Senate Hearings*")), industry representatives objected to provisions in the bill that required federal examination of investment counsel (*id.* at 746). Industry representatives also asserted that the investigatory powers granted to the Commission under the bill, if attended by publicity, could lead to a loss of confidence by clients (*id.* at 752). Senators Hughes and Wagner were quick to remind industry witnesses that their desire to avoid regulation must be weighed against Congress' duty to protect the public (*id.* at 753). Significantly, several industry representatives recognized that if additional regulation was called for, federal regulation was preferable to state regulation. See *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 88, 92 (1940) ("*House Hearings*"). Moreover, the President of the Investment Counsel Association assured members of the Senate Committee that the Association "strongly favor[ed]whatever method may be relied upon" to keep the profession "free from all forms of abuse." See *Senate Hearings, supra*, at 723; see also *id.* at 752. No member of the industry offered comments on the subject of remedies for defrauded clients.

The compromise version of the bill that received the endorsement of the industry took into account certain of its criticisms. The bill made no provision for examination of advisers prior to registration, reduced the amount of information to be disclosed in registration applications, and provided that investigations would be confidential. Industry representatives approved the bill with these changes. See *House Hearings, supra*, at 86-93.

The language that was enacted as the jurisdictional section of the Act (Section 214) first appeared in a committee print after the Senate Hearings. See Confidential Committee Print, S. 3580, 76th Cong., 3d Sess. Section 213 (1940). That version of the bill, and the version finally enacted into law, S. 4108, 76th Cong., 3d Sess. Section 214 (1940), both deleted the jurisdictional incorporations by reference, which had been used in earlier drafts, because the Investment Company Act and the Investment Advisers Act were designed to be independent and self contained. This change resulted at least in part because the investment adviser industry had indicated a preference for separation and restatement of each previously-overlapping provision of the two Acts. See *House Hearings, supra*, at 92, 137-138; *Senate Hearings, supra*, at 743.

Nothing in the legislative history explains why the final version of the jurisdictional provision in the Investment Advisers Act omitted reference to "actions

at law," while the jurisdictional provision in the Investment Company Act contained that reference. See S. 4108, 76th Cong., 3d Sess. Sections 44 and 214 (1940). Differences in the substantive provisions of the Acts may, however, suggest an answer. Section 30(f) of the Investment Company Act, 15 U.S.C. 80a-29(f), expressly created a private right of action for insider trading similar to Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b). See S. 4108, 76th Cong., 3d Sess. Section 30(f) (1940). The Investment Advisers Act, in contrast, contained no provision expressly creating a private remedy, and this may account for the difference in the jurisdictional provisions. But the difference does not support an inference that Congress meant to forbid private actions to enforce the substantive rules of the Investment Advisers Act.[10] It shows, at most, that Congress did not affirmatively provide for such actions. And that fact is quite neutral.

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[10] Although there was no contemporaneous explanation of the difference, those provisions were discussed in the House and Senate Committee Reports. Section 214, together with Sections 208-221 of the Investment Advisers Act, 15 U.S.C. 80b-8 to 80b-21 ("the administrative and enforcement machinery" of the statute), were described as being "generally comparable" to the corresponding provisions in the Investment Company Act. See S. Rep. No. 1775, *supra*, at 23; H.R. Rep. No. 2639, *supra*, at 30. Congress' view that the jurisdictional provision in the Investment Advisers Act is generally comparable to that in the Investment Company Act discredits the notion that Congress intended to permit private relief under one statute and not the other.

2. Judge Gurfein's dissenting opinion in *Abrahamson* also relied on the doctrine "that when a statute limits a thing to be done in a particular mode, it includes the negative of any other mode" (568 F.2d at 882), pointing out that Section 214 of the Investment Advisers Act authorizes only "equitable relief." From this he reasoned that although a private remedy for equitable relief may be acknowledged, a private damages remedy is foreclosed (*id.* at 882 n.8). This argument is wrong for two reasons: first, it would obliterate all implied private rights of action, and second, it erroneously assumes that Section 214 would be the source of the private remedy.

Unless the statute is silent on the question, there is no need to consider whether a private remedy should be implied to enforce a substantive right. But such silence almost always takes place in the context of the provision of some remedies. For example, the Court has concluded that there is a private right of action to enforce Section 10(b) of the Securities Exchange Act of 1934 even though nothing in Section 10(b) expressly creates such a right, and even though other portions of the Act create express private rights of action to enforce other substantive rules.[11] See *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 729-730. Judge Gurfein's rigorous application of the "expressio unius exclusio alterius" maxim would require the overruling of almost all of the

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[11] See Sections 9(e), 16(b), and 18 of the Securities Exchange Act of 1934, 15 U.S.C. 78i(e), 78p(b), 78r.

cases in which this Court recognized implied private rights of action. But there is no need to do so, because the maxim never has been carried to the full extent of its logic. The Court always has examined the legislative history of the substantive statute to determine whether Congress *intended*, in providing one remedy, to foreclose others. When the examination discloses such an intent, it is appropriate to apply only the remedies specifically enumerated.[12] See, *e.g.*, *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412, 420-421 (1975). But when the legislative debates or the structure of the statute do not disclose such an intent, it is appropriate to apply the prevailing rule that private remedies are available to enforce substantive rights given to private parties. See, *e.g.*, *Allen* v. *State Board of Elections*, 393 U.S. 544, 556-557 (1969). The "expressio unius exclusio alterius" approach adds little of value: the Court must divine the legislative plan statute-by-statute. *Cort* v. *Ash*, *supra*, 422 U.S. at 83 n.14.

At all events, Judge Gurfein was wrong in applying an "expressio unius exclusio alterius" approach to Section 214, because that Section does not create remedies or indicate what the appropriate remedies would be. It is a jurisdictional provision, and it supplements the general jurisdictional provision of 28

[12] See also pages 32-36 and 53-55 of the government's brief in *Chrysler Corp.* v. *Brown*, No. 77-922, argued Nov. 8, 1978, which applies this principle in arguing that neither 18 U.S.C. 1905 nor the Freedom of Information Act, 5 U.S.C. 552, supports a private right of action to enjoin disclosure of information by federal agencies.

U.S.C. 1331 by removing the amount-in-controversy requirement of the latter statute. Section 214 expresses, at best, the view of Congress that injunctive actions (but not damages actions) under the Investment Advisers Act should be entertained without regard to the amount in controversy.[13]

The substantive right in question comes from Section 206 of the Investment Advisers Act, not from Section 214. Section 206 establishes a duty but does not explicitly provide for any remedy, public or private, in equity or at law. It simply creates the right to be enforced. The statute creating the right—which has always been the critical provision in considering whether courts should recognize a private claim for relief[14]—thus does not support Judge Gurfein's position.

[13] It is clear that 28 U.S.C. 1331 provides jurisdiction to entertain implied private rights of action. See *Bell* v. *Hood*, 327 U.S. 678, 682-684 (1946); *Securities Investor Protection Corp.* v. *Barbour*, *supra*, 421 U.S. at 424; *Bivens* v. *Six Unknown Named Agents*, *supra*, 403 U.S. at 405 (Harlan, J., concurring). Cf. *Texas & Pacific Ry.* v. *Rigsby*, *supra*, 241 U.S. at 39-40. The courts of appeals that have recognized private rights of action under the Investment Advisers Act have relied on Section 1331 as the ground of jurisdiction. See A. 32 n.2; *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 875 n.22; *Wilson* v. *First Houston Investment Corp.*, *supra*, 566 F.2d at 1237 n.2.

[14] See, *e.g.*, *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 431-433 (looking principally to the content of the substantive right even though also relying on 15 U.S.C. 78aa, which gives courts jurisdiction of controversies "at law" in certain securities matters); *Securities Investor Protection Corp.* v. *Barbour*, *supra*, 421 U.S. at 424.

3. Although Section 214 of the Act thus does not support an inference that Congress intended either to authorize or to forbid private damages remedies under the Investment Advisers Act, Section 215(b) of the Act, 15 U.S.C. 80b-15(b), which provides for avoidance of illegal contracts, "strongly suggests" that a private right of action is consistent with the intentions of Congress.[15] *Abrahamson* v. *Fleschner, supra,* 568 F.2d at 874; *Sullivan* v. *Chase Investment Services of Boston, Inc., supra,* 434 F. Supp. at 182. Indeed, Professor Loss has remarked that private remedies are "perhaps more express than implied" when the statute contains such a voidability rule. III L. Loss, *Securities Regulation* 1758-1759 (2d ed. 1961). Accord, *Kardon* v. *National Gypsum Co., supra,* 69 F. Supp. at 514: "a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it." See also *Blue Chip Stamps*

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[15] Section 215(b) provides in pertinent part:

> Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void * * * as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract * * *."

Under this provision, an adviser's sale of securities to a client would be voidable if the sale violated the antifraud provision of the Investment Advisers Act. An advisory contract illegal under the Act also would be subject to avoidance.

v. *Manor Drug Stores, supra,* 421 U.S. at 735. This means, at a minimum, that equitable proceedings for rescission, restitution, and injunctive relief are available.[16] Equitable remedies of this nature would provide the relief sought by respondent. This complaint seeks an injunction, rescission, restitution, and an accounting—all traditional forms of equitable relief.[17] Moreover, proceedings for injunctions, rescission and restitution have always encompassed monetary relief where necessary to do equity. See *Porter* v. *Warner Holding Co.,* 328 U.S. 395, 399 (1946); *Wyandotte Transportation Co.* v. *United States,* 389 U.S. 191, 204 (1967). See also 6A A. Corbin, *Contracts* 833, 834 (1962); 5 *id.* at 573, 574 (1964); D. Dobbs, *Remedies* 618-619, 631 (1973).[18]

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[16] Judge Gurfein's dissenting opinion in *Abrahamson* v. *Fleschner, supra,* 568 F.2d at 882 n.8, acknowledges that "implication of a private right of action for rescission and restitution under § 215(b) would be well within the jurisdictional grant of § 214, and consistent with the notion that it is only *actions at law* which are inconsistent with the statutory scheme" (emphasis in original).

[17] Equitable remedies sought by private parties under the securities laws are, of course, subject to the traditional prerequisites. *Rondeau* v. *Mosinee Paper Corp.,* 422 U.S. 49, 59-63 (1975).

[18] A suit by a client seeking damages from an investment adviser has certain similarities to a surcharge proceeding brought by a beneficiary against a trustee. The surcharge proceeding is wholly equitable in nature, but monetary relief is routinely granted where a breach of fiduciary duty has caused injury to the trust corpus. See, *e.g.,* III *Scott on Trusts* §§ 199, 205-213 (3d ed. 1967); see also *McClintock on Equity* § 85 (2d ed. 1948). The application of such equitable prin-

4. Petitioners argue that Congress' failure expressly to create a private remedy in 1970 when amendments to the Investment Advisers Act were considered supports the inference that Congress intended to forbid all private remedies (Pet. Br. 17-20). That contention is incorrect.

In 1970 Congress amended both the Investment Advisers Act and the Investment Company Act. It expressly authorized private actions against investment advisers under Section 36(b) of the Investment Company Act, 15 U.S.C. 80a-35(b). Congress was well aware of the possibility that this might be cited —as petitioners have cited it—for the proposition that other rights are foreclosed. The legislative history refutes that proposition, however, because both committees stated that the creation of an express right of action under Section 36(b) should not be interpreted to affect other implied remedies. See S. Rep. No. 91-184, 91st Cong., 1st Sess. 16 (1969); H.R. Rep. No. 91-1382, 91st Cong., 2d Sess. 38 (1970).

In 1975 the Commission submitted a proposal to Congress that would amend Section 214 to extend jurisdiction, without regard to the amount in controversy, to "actions at law" under the Act. See S. 2849, 94th Cong., 2d Sess. Section 6 (1976). That proposal also was intended to confirm the existence

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ciples is, of course, appropriate in a federal action. *Hecht Co.* v. *Bowles*, 321 U.S. 321, 329-330 (1944). Whether or not an action can be brought in state court against an adviser is a separate question, as is its efficacy. See the discussion at pages 35-41, *infra*.

of private rights of action to enforce the Act's substantive rules. See *Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 17 (1976); *Hearings on H.R. 12981 and H.R. 13737 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce*, 94th Cong., 2d Sess. 36-37 (1976). The Senate Committee reported favorably on the provision as proposed by the Commission. The Committee agreed with the lower court decisions holding that private remedies may be implied under Section 206, pointing out that it would be "anomalous" to deny private remedies to advisory clients when investors may invoke implied remedies under other securities statutes. S. Rep. No. 94-910, 94th Cong., 2d Sess. 8-9 (1976). Although the bill did not come to a vote in either house, there is no indication that Congress would have rejected the Commission's proposal.[19]

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[19] Petitioners also argue that Congress' efforts in 1960 to strengthen the Investment Advisers Act in several respects, including the enforcement powers of the Commission, indicate a desire to preclude private remedies (Pet. Br. 17-18). But the legislative history does not mention that issue, and it is odd to contend that an amendment to strengthen enforcement silently disapproved private actions. Three years prior to the 1960 amendments, the Commission had taken the position that the existing language of Sections 206 and 214 was sufficient to support a private damages action in favor of a defrauded client. Brief for the SEC as *amicus curiae*, *Hull* v. *Newman, Kennedy & Co.*, Civ. Action No. 118-283 (S.D. N.Y., filed Sept. 10, 1957). It was not until several years later, after some uncertainty arose in the district courts, that

In sum, the recent activities of Congress do not suggest an intention to foreclose private remedies. Those activities are entirely consistent with the view that a private remedy may be implied. Petitioners' "excursion into extrapolation of legislative intent [is] entirely unilluminating." *Cort* v. *Ash*, *supra*, 422 U.S. at 83 n.14.

C. Private Remedies Are Consistent With The Underlying Purpose Of The Statute And Necessary to Achieve The Goals of Congress

1. The principal purpose of the Investment Advisers Act was to eliminate abuses by investment advisers that caused injury to both their clients and the national economy. *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 186-187. The legislative history repeatedly emphasizes protection of clients from unscrupulous and fraudulent practices. See, *e.g.*, H.R. Rep. No. 2639, *supra*, at 28; S. Rep. No. 1775, *supra*, at 21-22; 86 Cong. Rec. 2844-2845 (1940) (remarks of Sen. Wagner). Although Congress had enacted many securities antifraud provisions prior to the Investment Advisers Act, it concluded in 1940 that more effective remedies were needed. Thus, in describing existing securities statutes, Rep. Wolverton pointed out that:

> The Securities Act of 1933 and the Securities Exchange Act of 1934 have not been effectual in

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the Commission sought clarification of the language of Section 214. *Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 17 (1976).

> preventing the type of abuses that have grown up in the investment field. These acts merely provide for publicity. This, however, has not provided adequate security to the investing public.

86 Cong. Rec. 9816 (1940). Congress' solution to the problem of unscrupulous investment advisers was the creation of federal fiduciary standards. See *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11.

Private remedies available to defrauded clients of investment advisers would do much to achieve the purposes of the statute. The availability of damages for violations of the provisions of Section 206 would encourage ethical behavior by advisers. Although the "deterrent value" of private litigation can never be "ascertained with precision" (*Piper* v. *Chris-Craft Industries, Inc.*, *supra*, 430 U.S. at 40), the prospect of effective private redress for fraudulent conduct certainly would have some deterrent effect. By awarding damages to remedy injuries suffered by the special beneficiaries of the Act, moreover, the federal courts would create an enforcement mechanism "closely tailored to the precise congressional goal." *Ibid.* Protection of the economic interests of clients is the very point of the prohibition against adviser fraud.[20]

The availability of private remedies would not conflict with public enforcement or undermine other

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[20] See the remarks of Rep. Wolverton, 86 Cong. Rec. 9815 (1940), stressing the need "to save the investor from the losses that were incident to doing business with those who were not actuated by honest motives." See also *Senate Hearings*, *supra*, at 320.

statutory goals. This case is therefore quite different from *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458-463 (1974) (*"Amtrak"*). The legislative history of the statute involved there showed that Congress intended to foreclose a private remedy; moreover, private suits would have delayed railroad discontinuances and thus frustrated achievement of a statutory goal. Similarly, in *Securities Investor Protection Corp.* v. *Barbour*, *supra*, 421 U.S. at 420-425, the Court concluded "that the overall structure and purpose of the SIPC scheme are incompatible with such an implied right." *Id.* at 421. *Barbour* did not, however, question the appropriateness of private remedies under the federal securities laws, pointing out that private remedies had been implied "[i]n light of the 'broad remedial purposes' of the Act and the SEC's representation that private enforcement was necessary to effectuate those purposes * * *." *Id.* at 423.

Petitioners rely heavily on *Amtrak* and *Barbour*, but they do not come to grips with the essential distinction between private actions (such as those in *Amtrak* and *Barbour*) that might frustrate the legislative plan and those (such as in this case) that might help to carry out the plan. More than that, petitioners slight the fact that the plaintiffs in both *Amtrak* and *Barbour* sought relief that was identical to relief that public officials were authorized to seek, but which, for reasons of public policy, they had fore-

sworn.[21] In each case, the private plaintiffs were seeking the aid of the judiciary to achieve an objective that was at cross-purposes with decisions made by the responsible administrative agency.[22] But the com-

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[21] The fact that administrative agencies have not invoked available remedies is not, however, a sufficient reason to forbid private actions. As the government's brief in *Cannon* v. *University of Chicago*, *supra*, emphasized, it is important to consider whether the administrative remedy would produce the relief available in a suit. In *Cannon*, for example, an administrative process might lead to a suspension of funding for private institutions that discriminated on account of sex, but it might not effectively produce relief for individual victims of discrimination. A private remedy therefore could supplement the administrative process and would not undermine it. The same is true here.

[22] In *Amtrak*, for example, Congress gave to the Attorney General alone the authority to bring suit, principally in order to eliminate delays that had grown up under earlier legislation. The Attorney General's decision not to bring a suit would represent his judgment that discontinuation of service was appropriate, and the decision would clear the way for discontinuation. The allowance of private litigation would recreate the delay sought to be eliminated and, in the process, call into question the Attorney General's decision that discontinuation of service was not contrary to the public interest (414 U.S. at 462-464). Cf. *Morris* v. *Gressette*, 432 U.S. 491, 504-505 (1977). In *Barbour* the plaintiff had sought to require SIPC to initiate a proceeding for the liquidation of a broker-dealer. The statute provided that the Commission could seek to compel such action by SIPC, if SIPC refused to do so itself. The Court pointed out that Congress had named SIPC as the appropriate party to begin liquidation proceedings for insolvent broker-dealers because that was an extraordinary remedy and because its intervention might precipitate a dealer's collapse. Congress had chosen the Commission to supervise SIPC's obligation. To allow a parallel action by a private party to compel SIPC to intervene might unnecessarily

plaint in this case does not seek relief that the SEC would prefer be withheld. Indeed, the complaint seeks relief—private restitution of sums alleged to be wrongfully taken—that would not ordinarily be available in a suit brought by the Commission. The private action here therefore is a prototypical case of the suit that supplements the Commission's actions by adding deterrence of future wrongs and restitution for private harms to the prospective remedies available at the Commission's request. See *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 432.

Such supplementation is essential. The growth of the investment advisory industry since passage of the Advisers Act has been substantial. In the fiscal year that ended June 30, 1941, there were 753 advisers registered under the new Act. SEC, *Seventh Annual Report* 31 (1942). In the fiscal year that ended September 30, 1977, 4,823 persons were registered with the Commission as investment advisers. SEC, *43rd Annual Report* 234 (1979). The Commission's records show that the number of registrants increased to 5,385 as of December 31, 1978. As of June 30, 1969, registered advisers had more than $130 billion of assets under advisement. SEC, Institutional Investor Study Report, H.R. Doc. No. 92-64, 92d Cong., 1st Sess. 139 (1971). In its most recent budget submission to the Congress, for the fiscal year ended October

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cause a dealer to collapse at a time when SIPC or the Commission still believed that the dealer could be saved. *Securities Investor Protection Corp.* v. *Barbour*, *supra*, 421 U.S. at 420-423.

30, 1980, the Commission estimated that the assets currently under advisement by registered advisers totalled $200 billion. The Commission's examination and enforcement capabilities have not grown proportionately. In 1977 the Commission was able to conduct only 459 inspections of investment advisors. SEC, *43rd Annual Report* 234 (1979). The Commission believes that here, as in *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 432, the magnitude of the enforcement problem requires private litigation by persons in a position to learn the facts about particular advisers and bring them to the court's attention. The effectiveness of the Act "would be 'severely hampered' without the existence of a private remedy to supplement administrative procedures." *Regents of the University of California* v. *Bakke*, *supra*, slip op. 14 n.28 (Stevens, J., concurring and dissenting).

2. Judge Gurfein's dissenting opinion in *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 883, maintained that private enforcement is inconsistent with the statutory scheme because the Investment Advisers Act was designed as "a compulsory census of investment advisers, and not as a pervasive regulatory scheme." We question whether the "pervasiveness" of the regulatory scheme has much to do with the desirability of private enforcement. The essential question is whether there is a substantive federal rule and, if so, how that rule should be enforced. This Court therefore has acknowledged the propriety of implied rights of action "where congressional purposes are likely to be undermined absent private en-

forcement * * *";[23] or where there exist "standards of conduct that a private action could help to enforce * * *";[24] or where such actions will help to prevent "harm * * * of the type that the statute was intended to forestall * * *,"[25] as well as where there is "a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard."[26] The issue in every case is whether the remedy serves the purposes inherent in the statutory scheme. To determine that issue, one must examine the legislature's objectives. As we have discussed, the Investment Advisers Act was intended by Congress to protect clients from the fraudulent devices of advisers; the implication of a private remedy is wholly consistent with that scheme and acts as a necessary supplement to the Commission's enforcement of the statute. *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432.

At all events, Judge Gurfein's view that the Investment Advisers Act merely provides for a "compulsory census" fails to take into full account the substantive provisions of the statute. The Act requires most persons who render investment advice for

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[23] *Piper* v. *Chris Craft Industries, Inc., supra,* 430 U.S. at 25.

[24] *Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 424.

[25] *Wyandotte Transportation Co.* v. *United States, supra,* 389 U.S. at 202.

[26] *Cort* v. *Ash, supra,* 422 U.S. at 82.

compensation to register with the Commission and to disclose information concerning their methods of operation (Section 203, 15 U.S.C. 80b-3). Registered advisers must submit to inspections and maintain books and records concerning their operations (Section 204, 15 U.S.C. 80b-4). The contracts of advisers are subject to regulation (Section 205, 15 U.S.C. 80b-5), and certain persons are excluded from becoming advisers (Section 203(e), 15 U.S.C. 80b-3(e)). The Act contains a sweeping anti-fraud provision (Section 206, U.S.C. 80b-6) and provides for administrative injunctions and criminal penalties (Sections 209(e), 217, 15 U.S.C. 80b-9(e), 80b-17).[27] This scheme may be less "pervasive" than the one applicable to registered broker-dealers (see Securities and Exchange Act of 1934, Section 15, 15 U.S.C. 78*o*), but there can be no doubt that Congress has established a detailed regulatory scheme for the protection of advisory clients, and that the statute is far more than a mere "census taking" mechanism.

D. Regulation Of Investment Advisers Has Not Been A Traditional Concern Of The States, And Defrauded Clients Should Not Be Remitted to State Law Remedies

The final factor to be considered in determining whether the structure and purpose of a statute sup-

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[27] The Commission also has broad rule-making authority under the Act. See 15 U.S.C. 80b-3(c)(1), 80b-4, 80b-5, 80b-6(4), 80b-6a, 80b-10(a), and 80b-11. The Commission has adopted rules regulating, *inter alia,* the records to be kept by advisers, the use of performance fee contracts, the contents of advertising, and the safekeeping of clients' funds and securities. See 17 C.F.R. 275.204-2, 275.204-3, 275.205-1, 275.205-2, 275.206(4)-1 and 275-206(4)-2.

port private remedies is whether the subject is "one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law." *Cort* v. *Ash*, *supra*, 422 U.S. at 78. See also *Piper* v. *Chris-Craft Industries, Inc.*, *supra*, 430 U.S. at 40; *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 478-479.

It is beyond question that Congress found state supervision inadequate and intended to create federal standards to govern the conduct of investment advisers.[28] When the statute was enacted, there was no scheme of regulation in 42 of the 48 states. See *Senate Hearings*, *supra*, at 96-1004. Representatives of the investment advisory industry themselves acknowledged the absence of adequate state regulation and called for a uniform system of federal regulation. See *House Hearings*, *supra*, at 88, 92. The Act thus created, as this Court has recognized, a new federal standard of fiduciary duty. *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11.

Although state regulation of investment advisers has become more common since passage of the Act, "[s]tate controls with respect to conduct in the investment advisory field are of extremely limited scope

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[28] See S. Rep. No. 1775, *supra*, at 21: "[P]rotection of investors requires the regulation of investment advisers on a national scale. * * * [T]he problems and abuses of investment advisory services * * * cannot be effected without Federal legislation. * * * Virtually no limitations or restrictions exist with respect to the honesty and integrity of individuals who may solicit funds to be controlled, managed, and supervised."

and significance * * *." See SEC, Report of the Special Study of Securities Markets, H.R. Doc. No. 95, Pt. 1, 88th Cong., 1st Sess. 374 (1963). The most recent survey conducted by the Commission indicates that 17 jurisdictions still have no registration requirements for advisers, and 19 jurisdictions have no examination, qualification, capital, or bonding requirements. See *Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 19-23 (1976); Ahart, *Suggested Amendments to the Investment Advisers Act*, 6 Sec. Reg. L.J. 226, 229-234 (1978). Moreover, most state statutes were enacted after and patterned on the federal statute. See Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 Mich. L. Rev. 308, 324 & n.103 (1975). The federal government remains the primary regulator of investment advisers, and enforcement of federal standards will not supersede an established body of state law.

Petitioners nonetheless contend that claims of the kind presented in this case are traditionally relegated to state law (Pet. Br. 25-27). They rely on the ability of a trust's beneficiaries to sue trustees for breach of fiduciary duty. Petitioners argue that this branch of "the common law offers a formidable arsenal of precedents, presumptions and remedies" (Pet. Br. 28). But that merely states the obvious. This Court has recognized repeatedly that the antifraud provisions of the federal securities laws regulate conduct previously

regulated by the common law. See *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 195 ("Congress codified the common law 'remedially'" under the Investment Advisers Act); see also *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 744. As one commentator has noted, the federal antifraud provisions derive from the common law and are superimposed on it. III Loss, *Securities Regulation*, *supra*, at 1430, 1435. But Congress enacted federal statutes precisely because common law remedies had proved to be inadequate, and the existence of such state remedies therefore is not important here. See *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 434-435; *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 12 ("there is redress under § 10(b) whatever might be available as a remedy under state law").[29] See also *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 461-463 (1969); *SEC* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, 210-212 (1967); *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959).

At all events, the common law is not as helpful to clients of investment advisers as petitioners imply. Most of the state cases cited by petitioners involve the construction of testamentary trusts, the beneficiaries

[29] In many cases now brought under Section 10(b) the aggrieved purchaser or seller of securities (alleging both scienter and deception) could have brought an action under common law principles of deceit. But the availability of state law tort remedies has not precluded implication of private remedies under Section 10(b).

of which are usually limited in number and familiar to the testator. See, *e.g.*, *In re Estate of McLaughlin*, 43 Cal. 2d 462, 274 P.2d 868 (1954); *In re Ridings' Estate*, 297 N.Y. 417, 79 N.E.2d 735 (1948); *In re Estate of Van Deusen*, 37 App. Div. 2d 131, 322 N.Y.S. 2d 951 (1971).[30] Although many investment advisers handle substantial amounts of their clients' funds, the principles developed in the cases cited by petitioners have no direct relevance in actions brought against those investment advisers who sell advice or financial analysis and do not manage their clients' portfolios. Moreover, application of state law standards to investment advisers may result in conflicting interpretations and divergent standards of duty.[31]

[30] State trust law principles often have proved to be inadequate to protect the interests of participants in large investment trusts. See, *e.g.*, *Hazzard* v. *Chase National Bank of City of New York*, 159 Misc. 57, 287 N.Y.S. 541 (Sup. Ct. 1936), aff'd, 282 N.Y. 652, 26 N.E.2d 801 (1940) ("I am reluctantly constrained to conclude that the defendant has successfully exempted itself from liability in this sad picture of high finance. For the inexcusable terms of the indenture, the trustee cannot be held accountable. It performed in full the negligible duty which was imposed upon it * * *. It did nothing more, but, having done that, it is absolved under the law") (287 N.Y.S. at 572). The inadequacy of state law principles of fiduciary duty was the very reason for enacting the Trust Indenture Act, 15 U.S.C. 77aaa *et seq.*, the Investment Company Act, 15 U.S.C. 80a-1 *et seq.*, and the Investment Advisers Act, 15 U.S.C. 80b-1 *et seq.*

[31] Compare *Barnes* v. *Peat, Marwick, Mitchell & Co.*, 69 Misc. 2d 1068, 332 N.Y.S. 2d 281 (Sup. Ct. 1972), modified on other grounds, 42 App. Div. 2d 15, 344 N.Y.S. 2d 645 (1973)

In these circumstances, this Court's observations in *Borak* are most pertinent: "[I]f federal jurisdiction were limited * * * victims [of fraud] would be obliged to go into state courts for remedial relief. And if the law of the State happened to attach no responsibility to the use of [the fraudulent device], the whole purpose of the section might be frustrated" (377 U.S. at 434-435).

In light of Congress' decision to create federal fiduciary standards, it would be anomalous for federal courts to relegate defrauded clients to state law remedies. See *Wilson* v. *First Houston Investment*

(right of action implied for violation of "blue sky" antifraud provision in favor of broker's client) with *Herdegen* v. *Paine, Webber, Jackson & Curtis*, 31 Misc. 2d 104, 220 N.Y.S. 2d 459 (Sup. Ct. 1961) (state court refuses to recognize a private right of action in favor of a customer who received fraudulent advice under either common law or state "blue sky" antifraud provision); see also *Jones Memorial Trust* v. *Tsai Investment Services, Inc.*, 367 F. Supp. 491, 498 (S.D. N.Y. 1973) (no right of action under state law where registered investment adviser is not the stock broker in a fraudulent transaction); *Twomey* v. *Mitchum, Jones & Templeton, Inc.*, 262 Cal. App. 2d 690, 697-720, 69 Cal. Rptr. 222, 229-243 (1968) (state remedy exists if violations of Securities Exchange Act of 1934 are found); *Miller* v. *Livingstone*, 25 App. Div. 2d 106, 267 N.Y.S. 2d 249, aff'd, 18 N.Y. 2d 967, 278 N.Y.S. 2d 206 (1966) (falsity of financial statement and misrepresentation of qualifications are insufficient to state a right of action for fraud); see also *Koos* v. *Ludwig*, 22 App. Div. 2d 666, 253 N.Y.S. 2d 380 (1964); *Brown* v. *Bullock*, 35 Misc. 2d 370, 230 N.Y.S. 2d 660 (Sup. Ct.), aff'd, 17 App. Div. 2d 424, 235 N.Y.S. 2d 837 (1962); *Levine* v. *Silverman*, 43 Misc. 2d 415, 251 N.Y.S. 2d 68 (Sup. Ct. 1964); Note, *The Regulation of Investment Advisers*, 14 Stan. L. Rev. 827, 832-834 (1962).

Corp., *supra*, 566 F.2d at 1242-1243; *Sullivan* v. *Chase Investment Services of Boston, Inc.*, *supra*, 434 F. Supp. at 184; cf. *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 191-192. Closing the doors of the federal courts to claims of fraud would increase the possibility that investment advisers with clients in many different states (advisers who themselves advocated uniform federal regulation) would be subject to divergent state law standards of duty. Congress' creation of a uniform system of regulation weighs heavily against such a result.[32]

E. Private Remedies Under The Act Are Consistent With *Blue Chip Stamps*

Judge Gurfein's dissenting opinion in *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 884, expressed concern about creation of an "open-ended" private right of action and suggested that a private right of action to enforce Section 206 would conflict with the purchaser-seller standing requirement of *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*. That reasoning fails to take into account the essential difference between Section 206 of the Investment Advisers Act

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[32] Reliance on state law principles to resolve the issues raised by this complaint would be most inappropriate. The complaint charges that the advisory contract is void for failure to comply with the registration requirements of the federal Act. It also alleges self-dealing transactions and misappropriation of investment opportunities violative of the antifraud provision of the Act. These allegations should be analyzed under the express terms and policies of the Act, not under common law principles.

and Section 10(b) of the Securities Exchange Act: Section 206 safeguards the fiduciary relationship between investment advisers and their clients, while Section 10(b) protects the integrity of securities transactions and securities markets, extending to anonymous buyers and sellers on exchanges who have no other relationship to each other. *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11; *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 728.

In *Blue Chip Stamps* the Court considered the consequences of the express statutory limitation in Section 10(b) that the fraud be "in connection with the purchase or sale of any security." 421 U.S. at 733. There could be no private damages remedy without a purchase or sale. The same form of analysis, applied here, demonstrates that Judge Gurfein's concern is unwarranted. Subsections (1), (2) and (4) of Section 206, 15 U.S.C. 80b-6(1), (2) and (4), proscribe fraudulent practices of investment advisers even if they do not occur in connection with securities transactions. The omission of a purchase or sale requirement in subsections (1), (2) and (4) cannot be deemed to be inadvertent, particularly in light of the fact that subsection (3) contains such a requirement.[33] See *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 734.

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[33] Section 206(3), 15 U.S.C. 80b-6(3), which concerns purchases or sales of securities for a client's account by an investment adviser acting as a principal or broker for the account of another person, expressly relates to purchase or sale transactions.

The prohibition in Section 206 of fraudulent practices, even when not in connection with a securities purchase or sale, reflects the recognition that the devices employed by investment advisers to defraud their clients may have little direct relationship to specific securities transactions. For example, a customer may be defrauded when an adviser receives compensation on the basis of false promises of large profits. See *SEC* v. *C. R. Richmond & Co.*, 565 F.2d 1101, 1106 (9th Cir. 1977); *Marketlines, Inc.* v. *SEC*, 384 F.2d 264, 266 (2d Cir. 1967), cert. denied, 390 U.S. 947 (1968). Similarly, clients may be defrauded when an adviser falsely promises to guarantee them against losses. See *SEC* v. *Seipel*, [1952-1956] CCH Fed. Sec. L. Rep. ¶ 90,735 (D. D.C. 1954), aff'd, 229 F.2d 758 (D.C. Cir. 1955). An adviser who conceals his insolvency or precarious financial condition from clients also has acted fraudulently. See *Intersearch Technology, Inc.*, [1974-1975] CCH Fed. Sec. L. Rep. ¶ 80,139 at 85,189 (SEC 1975). And fraud may occur when an adviser secretly misuses the funds of his client for personal benefit. See *Steadman Security Corp.*, [1977-1978] CCH Fed. Sec. L. Rep. ¶ 81,243 at 88,339-5 to 88,339-8 (SEC 1977), appeal pending, No. 77-2415 (5th Cir.).

The absence of a purchase or sale limit to the scope of Section 206 does not mean, however, that private actions will threaten open-ended liability or unmanageable judicial problems. Because Section 206 must be understood in light of the legislative purpose to protect the fiduciary relationship between client and adviser (*SEC* v. *Capital Gains Research Bureau, Inc.*,

supra, 375 U.S. at 191), it has its own limits on the scope of liability. The statute presupposes the existence of a relationship of financial trust or reliance between the defendant and the plaintiff. That effectively limits the number of potential plaintiffs and rules out unforeseen liabilities to the general public. A "privity of dealing or even personal contact between potential defendant and potential plaintiff" would be the rule in any action under the Investment Advisers Act. *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 745, 747. See also *Reserve Management Corp.* v. *Anchor Daily Income Fund, Inc.*, [1978] CCH Fed. Sec. L. Rep. ¶ 96,566 at 94,371 (S.D. N.Y. 1978).

The clients of an adviser are a determinable class; they are often personally known by the adviser and their reliance on the adviser's honesty is clearly foreseeable. Cf. *Affiliated Ute Citizens* v. *United States*, *supra*, 406 U.S. at 151-154. Moreover, defrauded clients will be entitled to damages only "to the extent that they can be shown." See *Mills* v. *Electric Auto-Lite Co.*, *supra*, 396 U.S. at 389.[34]

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[34] There are doubtless a number of open questions concerning the necessary elements of a private right of action. *Cf. SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 194; *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976). The courts below did not reach any such issues. This Court need decide only whether a remedy should be implied, as in *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 431-435. Any questions concerning the elements of the claim and the appropriate limits of relief should be left for consideration in the first instance by the lower courts. Cf. *SEC* v. *National Securities, Inc.*, *supra*, 393 U.S. at 465.

In sum, because the duty of the adviser to his clients is well established, and because the plaintiff class is limited to persons who are entitled to rely on the faithful performance of that duty, private suits for damages are well suited to help enforce the substantive rules that Congress has prescribed.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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IN THE

Supreme Court of the United States

OCTOBER, TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; AND MORTGAGE TRUST OF AMERICA,

Petitioners,

vs.

HARRY LEWIS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC. AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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BRIEF OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC. AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

This brief is submitted on behalf of the Investment Counsel Association of America, Inc. ("ICAA") as amicus curiae in support of the petitioners. All parties have consented in writing to the filing of this brief. (S. Ct. R. 40).

The ICAA was organized in 1937 as an association of those investment advisers engaged in rendering investment counsel

services to clients. The member firms of ICAA constitute virtually all of the larger and many of the smaller firms registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 ("Act") who are independent of the banking and brokerage industries and render continuous portfolio supervision and advice to clients on the basis of their individual needs and circumstances.

The ICAA has no interest in the essentially private aspects of the dispute; the ICAA's concern is with an affirmance of an implied right of action against investment advisers. The ICAA was an important participant in the original hearings and negotiations which culminated in the Act and therefore feels that it is well qualified to review the Act's legislative history.

ARGUMENT

I.

Section 214 of the Act Gives No Jurisdiction Over Actions at Law

Section 214 of the Act granted jurisdiction to the district courts to hear criminal prosecutions and "suits in equity to enjoin any violation of this subchapter"; it made no provision for "action at law." This differentiates the Act from all other federal securities acts. In each of the Five federal securities laws which preceded the Act, Congress conferred jurisdiction on the district courts using the same clear and unambiguous words: "actions at law brought to enforce any liability or duty created by" the statute.[1] These words which appeared in drafts of the Act were eliminated from the Act as passed. Congress purposely limited district court jurisdiction under the Act to only those

1. Securities Act of 1933, Section 22, 15 U. S. C. § 77v; Securities Exchange Act of 1934; Section 27, 15 U. S. C. § 78aa; Public Utility Holding Company Act of 1935, Section 25 § 79y; Trust Indenture Act of 1939, Section 14 U. S. C. § 80a-43. See, Appendix, Exhibit A.

enforcement proceedings expressly authorized by the Act. The Act does not provide for and Congress purposely refused to confer jurisdiction over actions at law.

The difference between the Act and the other federal securities laws is intentional. The Investment Company Act and the Investment Advisers Act were both passed by Congress on the same day, August 22, 1940, and constituted Title I and II respectively of the same bill, H. R. 10065. In Title I Congress specifically included the "actions at law" language, thus creating district court jurisdiction over such actions. In Title II, however, Congress omitted the "action at law" language. This difference in the wording of the portions of the same bill, especially when it involves crucial jurisdictional language, can only mean that Congress intended that the difference in wording be given effect and be significant.

The omission of any reference to "actions at law brought to enforce any duty or liability" in Section 214 of the Act represents a deliberate Congressional decision to withhold jurisdiction from the federal courts over private damage actions and to refrain from creating any such right. Analysis of the legislative history of the Act confirms this conclusion.

II.

A Review of the Entire Legislative History Demonstrates That Congress Intended That the District Courts Have No Jurisdiction Over Actions at Law Under the Act

A. Birth of the Act—1940

The history of the birth of the Act provides compelling evidence that Congress considered, and purposely eliminated, a grant of jurisdiction over actions at law. Early drafts of the Act contained, either directly or by reference, language regarding "actions at law."[2] These were opposed by the industry[3] and

2. See, *e.g.*, S. 3580, 76th Cong., 3d Sess. 98 (introduced by Sen. Wagner on March 14, 1940); H. R. 8935, 76th Cong., 3d Sess.

(Footnote continued on next page.)

negotiations between the industry and the SEC ensued.[4] The ICAA played an important role in those negotiations and in the drafting that followed. The result was an industry draft that deleted any references to jurisdiction over "actions at law" or to "liability". With those deletions the draft became the Act;

> "In connection with the investment advisers, I think that Robert Page who represented Scudder, Stevens & Clark . . . submitted a draft of the bill to us, which is the draft that is included in this new bill."[5]

B. Subsequent History—the 1960's and 1970's

The subsequent history of the Act also provides compelling evidence that Congress intended to withhold federal court jurisdiction over private damage actions brought under the Act. Congress, in 1960, amended the Act extensively, strengthening the SEC's enforcement powers.[6] No change to § 214 was proposed[7] and no change was made. In 1970 the Act was amended

(Footnote continued from preceding page)

98 (introduced by Cong. Lea on March 14, 1940). See, Appendix, Exhibit B. a chart which traces the modifications in the jurisdictional sections of the Act and the Investment Company Act from March through August of 1940 and Exhibit C. which contains copies of the complete text of each draft of the jurisdictional sections.

3. Investment Trusts and Investment Companies: Hearings on H. R. 10065 before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. (1940) [hereinafter "House Hearings"] at 88-90, 92. Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940) [hereinafter "Senate Hearings"] at 712-723, 737-754.

4. House Hearings at 88-90, 92; S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).

5. *Senate Hearings* at 1124.

6. The following sections of the Act were amended in 1960; 202(a)(12), 202(a)(18), 203(c)(1)(f), 203(c)(2), 203(d), 210(b), 211(a), and 217. Three sections or subsections were added: 206(4), 208(d) and 222.

7. The SEC made "extensive proposals." S. Rep. No. 1760, 86th Cong. 2d Sess. 2 (196).

again; its companion statute, the Investment Company Act, was also amended. Although a carefully delimited express right of action against an investment advisers to a mutual fund was added to the Investment Company Act,[8] no provision for jurisdiction over "actions at law" was added to the Act. Finally, in 1975 the SEC proposed that § 214 be amended to add "actions at law brought to enforce any liability or duty created by [the Act]"[9] and hearings were held on the proposal.[10] No change was made.

In sum, the legislative history demonstrates that Congress had ample opportunity to expressly include the "action at law" language in the Act. Its refusal to do so can only mean that Congress intended to withhold federal court jurisdictions over private damage actions brought under the Act.

III.

No Private Right of Action Under the Act Should Be Implied

In *Cort* v. *Ash*, 422 U. S. 66 (1975), this Court set down the tests for determining whether a private remedy is implicit in a statute not expressly providing such remedy. These tests are:

> "First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted,' . . . that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legis-

8. Section 36(b), Investment Company Act.

9. Investment Advisers Act Release No. 491 (December 15, 1975), [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,341.

10. Investment Advisers Amendments; Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 2d Sess. (1976); Investment Advisers Act Amendments: Hearings on H. R. 13737 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 2d Sess. (1976).

> lative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?" 422 U. S. at 78.

Applying *Cort*, no private right of action ought to be implied under the Act.

"Indication of Legislative Intent"

The clearest indication that Congress did not intend to create such rights is the clear and deliberate Congressional refusal to include in the Act the very language which would have given the federal courts the jurisdiction to entertain actions at law.[11] The implication of a private right would ignore the distinctive legislative history of the Act.

"Legislative Scheme"

A private right of action is inconsistent with the legislative scheme. The structure of the Investment Advisers Act contemplates limited regulation of the industry through SEC enforcement proceedings and through the threat of criminal penalties. Section 203, 15 U. S. C. § 80 B-3, provides for registration of investment advisers which fulfills the census-taking purpose of the Act,[12] by providing the information needed by the SEC to effectuate regulation of the industry.[13]

Section 209(a) of the Act, 15 U. S. C. § 80b-9(a), provides that enforcement is to be by the *Commission*.

> "Whenever it shall appear *to the Commission* . . . that the provisions of this subchapter or of any rule or regulation prescribed under the authority thereof, have been or are about to be violated by any person, it may *in its discretion*

11. See, discussion in Sections I and II of this brief.

12. *Senate Hearings* at 48, 51, 319.

13. The same function is served by the periodic reports provision in Section 205, 15 U. S. C. § 806-4.

> require . . . such persons to file with it a statement . . . ." (emphasis added).

Similarly § 209(e) provides that:

> "Whenever it shall appear *to the Commission* that any person has engaged, is engaged, or is about be engage in any act or practice constituting a violation of any provision of this subchapter, . . . it may *in its discretion* bring an action . . . *to enjoin* . . ." (emphasis added).

Section 210, 15 U. S. C. § 80B-10, limits disclosure by the Commission that an investigation is being conducted.

The Act reflects a deliberate Congressional balancing of the interests of the investment advisory industry and the interests of its clients.[15] The implication of a private right of action under the Act would destroy that balance by substantially altering the pattern of regulation of an industry which, as recently as December of 1975, the Securities and Exchange Commission advised Congress "[can have] substantial impact . . . on both the economy and the public investor . . ."[16] For 37 years prior to *Abrahamson* v. *Fleschner*, 568 F. 2d 862 (2d Cir. 1977), *cert. denied* ..... U. S. ....., 98 S. Ct. 2253 (1978), an unrestricted private right of action was not a part of the pattern of regulation. During that period Congress on three occasions (1960, 1970, 1975) re-examined the regulatory scheme and did not articulate such a right.

If Congress had intended a general private right of action against investment advisers, why, in 1970, did it merely enact the limited right afforded by Section 36(b) of the Investment Company Act of 1940 and make no change in Section 206 of the Advisors Act? We believe that in 1970 Congress reaffirmed

14. See *House Hearings* at 89-90, 95, S. Rep. No. 1775, 76th Cong., 3d Sess. 20-21 (1940) (Remarks of Rep. Wolverton).

15. *Senate Hearings* at 1124.

16. Statement of the Securities and Exchange Commission in support of Proposed Amendments to the Investment Advisers Act of 1940, transmitted to Congress by Chairman Hills in December, 1975.

its longstanding decision not to create a private right of action under Section 206.

In 1970 Congress did expressly consider and create a private right of action in this industry but it carefully circumscribed that right.[17] In suits relating to mutual fund advisory fees, Congress (1) placed the burden of proof of breach of fiduciary duty on the plaintiff (§ 36(b)(1)); (2) provided that action by the board and shareholders of the investment company (the client) is to be given such consideration by the court as is deemed appropriate under all the circumstances (§ 36(b)(2)); (3) required that no action be brought or maintained against any one other than the recipient of the advisory fee and that no damages or other relief be granted against any person other than the recipient; (4) provided that no award of damages shall be recoverable for any period prior to one year before the action was instituted and (5) limited the award of damages to "actual damages resulting from the breach of fiduciary duty", in no event, to exceed the amount of compensation or payment received from the client (§ 36(b)(3)). Thus, in creating a private right of action for the group of clients which has the broadest public involvement—an investment company—Congress once again balanced industry need with client interest and circumscribed the private right. It would be anomalous for the courts to afford private clients greater protection through an implied right of action than that which Congress afforded to the thousands of public shareholders of mutual funds.

"State Law"

Omission of jurisdiction over "actions at law" is implicit recognition of the existence of adequate remedies under state law for specfic breaches of an adviser's duty.

Thus, applying *Cort*, implication of a private right of action is unjustified.

17. Investment Company Act of 1940, § 36(b), 15 U. S. C. § 80a-35(b).

CONCLUSION

The creation of this implied private right must be viewed in light of this Court's admonition in *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185, 211 (1976):

> "We would be unwilling to bring about this result, absent *substantial support* in the legislative history, and there is none." (Emphasis supplied)

Given the absence of the words "actions at law," given the careful Congressional circumscription of the only express right of action against investment advisers, given the fact that the Act (unlike any other Securities Act) contains no provision for damages, given a foreseeable flood of cases which, under the rubric of "fraud", will inevitably challenge the judgments of the investment advisers with the benefit of hindsight, and given the importance of this industry to the national economy, unless "substantial support" is found in the legislative history (and we do not find it), this Court should put an end to this recently fashioned implied private rights of action. (*See, SIPC* v. *Barbour*, 421 U. S. 412 (1975)).

If a private right of action is an appropriate remedy in this industry, that right of action is for Congress to fashion.

For the foregoing reasons, the decision of the Ninth Circuit Court of Appeals in *Transamerica Mortgage Advisors, Inc. et al.* v. *Lewis*, 575 F. 2d 237 (9th Cir. 1978) should be reversed.

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EXHIBIT A.

JURISDICTIONAL PROVISIONS OF THE SECURITIES LAWS

Securities Act of 1933

Section 22, 15 U. S. C. § 77v, provides:

Jurisdiction of offenses and suits

(a) The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.

(b) In case of contumacy or refusal to obey a subpena issued to any person, any of the said United States courts, within the jurisdiction of which said person guilty of contumacy or refusal to obey is found or resides, upon application by the Commission may issue to such person an order requiring such person to appear before the Com-

mission, or one of its examiners designated by it, there to produce documentary evidence if so ordered, or there to give evidence touching the matter in question; and any failure to obey such order of the court may be punished by said court as a contempt thereof.

Securities Exchange Act of 1934

Section 27, 15 U. S. C. § 78aa, provides:

Jurisdiction of offenses and suits

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

Public Utility Holding Company Act of 1935

Section 25, 15 U. S. C. § 79y, provides:

Jurisdiction of offenses and suits

The District Courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this chapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this chapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this chapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28, and section 7 of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against the Commission in any court.

Trust Indenture Act of 1939

Section 322, 15 U. S. C. § 77vvv, provides:

Court review of orders; jurisdiction of offenses and suits

(a) Orders of the Commission under this subchapter (including orders pursuant to the provisions of sections 77eee(b) and 77ggg(c) of this title) shall be subject to

review in the same manner, upon the same conditions, and to the same extent, as provided in section 77i of this title, with respect to orders of the Commission under the Securities Act of 1933.

(b) Jurisdiction of offenses and violations under, and jurisdiction and venue of suits and actions brought to enforce any liability created by, this subchapter, or any rules or regulations or orders prescribed under the authority thereof, shall be as provided in section 77v(a) of this title.

Investment Company Act of 1940

Section 44, 15 U. S. C. § 80a-43, provides:

Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 80a—33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291,

1292, and 1294 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court. The Commission may intervene as a party in any action or suit to enforce any liability or duty created by, or to enjoin any noncompliance with, section 80a—35(b) of this title at any stage of such action or suit prior to final judgment therein.

Investment Advisers Act of 1940

Section 214, 15 U. S. C. § 80b-14, provides:

Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court.

EXHIBIT B

APPENDIX B

Date	Document Designation	Title I (Investment Company Act)	Title II (Investment Advisers Act)
3/12/40	Committee Print S.	Jurisdiction of Offenses and Suits Sec. 40. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.	Application of Title I Sec. 203. The provisions of the following sections of title I are hereby incorporated in this title as though fully set forth herein: Sections 3, 34(b), 35(b) and (c), 36, 37(e) and (f), 38, 39, 40, 41, 42, 43, 45, 46, and 47.
3/14/40	S. 3580	Jurisdiction of Offenses and Suits Sec. 40. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.	Application of Title I Sec. 203. The provisions of the following sections of title I are hereby incorporated in this title as though fully set forth herein: Sections 3, 34(b), 35(b) and (c), 36, 37(e) and (f), 38, 39, 40, 41, 42, 43, 45, 46, and 47.
3/14/40	H.R. 8935	Jurisdiction of Offenses and Suits Sec. 40. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.	Application of Title I Sec. 203. The provisions of the following sections of title I are hereby incorporated in this title as though fully set forth herein: Sections 3, 34(b), 35(b) and (c), 36, 37(e) and (f), 38, 39, 40, 41, 42, 43, 45, 46, and 47.
5/13/40	Framework of Proposed Investment Company Bill (Title I)	Court Review of Orders: Jurisdiction of Offenses and Suits (Sections 39, 40 Present Bill) Sec. 31. The provisions of sections 39 and 40 in the present Bill are satisfactory.	[No comparable "Framework" for the Investment Advisers Act was found]

Date	Document Designation	Title I (Investment Company Act)	Title II (Investment Advisers Act)
5/24/40	Confidential Committee Print S. 3580	Jurisdiction of Offenses and Suits Sec. 40. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.	Jurisdiction of Offenses and Suits Sec. 213. The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.
5/28/40	Confidential Committee Print S. 3580	Jurisdiction of Offenses and Suits Sec. 44. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.	Jurisdiction of Offenses and Suits Sec. 213. The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.
5/31/40	Confidential Committee Print S. 3580	Jurisdiction of Offenses and Suits Sec. 44. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.	Jurisdiction of Offenses and Suits Sec. 213. The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the

Date	Document Designation	Title I (Investment Company Act)	Title II (Investment Advisers Act)
			jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.
6/4/40	Confidential Committee Print S. 3580	Jurisdiction of Offenses and Suits Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder.	Jurisdiction of Offenses and Suits Sec. 213. The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.
6/6/40	Confidential Committee Print S. 3580	Jurisdiction of Offenses and Suits Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and,	Jurisdiction of Offenses and Suits ~~Sec. 213~~ 214. The district courts of the United States, ~~the Supreme Court of the District of Columbia~~, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder,

Date	Document Designation	Title I (Investment Company Act)	Title II (Investment Advisers Act)
		concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder.	and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.
6/6/40	S. 4108	Jurisdiction of Offenses and Suits Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder.	Jurisdiction of Offenses and Suits Sec. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.
6/12/40	H.R. 10065	Jurisdiction of Offenses and Suits Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial	Jurisdiction of Offenses and Suits Sec. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any

Date	Document Designation	Title I (Investment Company Act)	Title II (Investment Advisers Act)
		courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder.	violation of this title or the rules, regulations, or orders thereunder.
6/18/40	H.R. 10065 (Reported with amendments)	Jurisdiction of Offenses and Suits Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder.	Jurisdiction of Offenses and Suits Sec. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.
7/30/40	S. 4108 amendments	No change in Sec. 44. from S. 4108 of 6/6/40	No change in Sec. 214. from S. 4108 of 6/6/40
8/5/40	H.R. 10065 On Second Reading	Jurisdiction of Offenses and Suits Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations	Jurisdiction of Offenses and Suits Sec. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or

Date	Document Designation	Title I (Investment Company Act)	Title II (Investment Advisers Act)
		of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder.	the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.
8/22/40	Public Law No. 768	Jurisdiction of Offenses and Suits Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder.	Jurisdiction of Offenses and Suits Sec. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder.

EXHIBIT C.

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15	Public Law No. 768	August 22, 1940	A40-41

A15

[COMMITTEE PRINT]

MARCH 12, 1940

76TH CONGRESS
3D SESSION

S.

IN THE SENATE OF THE UNITED STATES

MARCH ....., 1940

Mr. ..... introduced the following bill; which was read twice and referred to the Committee on

JURISDICTION OF OFFENSES AND SUITS

SEC. 40. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.

(b) Any criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his or its principal office or place of business.

APPLICATION OF TITLE I

SEC. 203. The provisions of the following sections of title I are hereby incorporated in this title as though fully set forth herein: Sections 3, 34(b), 35(b) and (c), 36, 37(e) and (f), 38, 39, 40, 41, 42, 43, 45, 46, and 47.

76TH CONGRESS
3D SESSION

S. 3580

IN THE SENATE OF THE UNITED STATES

MARCH 14 (legislative day, MARCH 4), 1940

Mr. WAGNER introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

---

JURISDICTION OF OFFENSES AND SUITS

SEC. 40. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.

(b) Any criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his or its principal office or place of business.

APPLICATION OF TITLE I

SEC. 203. The provisions of the following sections of title I are hereby incorporated in this title as though fully set forth herein: Sections 3, 34(b), 35(b) and (c), 36, 37(e) and (f), 38, 39, 40, 41, 42, 43, 45, 46, and 47.

76TH CONGRESS
3D SESSION

H. R. 8935

IN THE HOUSE OF REPRESENTATIVES

MARCH 14, 1940

Mr. LEA introduced the following bill; which was referred to the Committee on Interstate and Foreign Commerce

---

JURISDICTION OF OFFENSES AND SUITS

SEC. 40. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.

(b) Any criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his or its principal office or place of business.

APPLICATION OF TITLE I

SEC. 203. The provisions of the following sections of title I are hereby incorporated in this title as though fully set forth herein: Sections 3, 34(b), 35(b) and (c), 36, 37(e) and (f), 38, 39, 40, 41, 42, 43, 45, 46, and 47.

May 13, 1940.

FRAMEWORK OF PROPOSED INVESTMENT COMPANY BILL

(Title I)

Embodying Suggestions Resulting from Conferences Between Securities and Exchange Commission and Representatives of Investment Companies.

COURT REVIEW OF ORDERS: JURISDICTION OF OFFENSES AND SUITS

(Sections 39, 40 Present Bill)

The provisions of Sections 39 and 40 in the present Bill are satisfactory.

[The "framework" deals only with the proposed Investment Company Bill. There is no comparable framework for the Investment Advisers Act.]

[CONFIDENTIAL COMMITTEE PRINT]

MAY 24, 1940

76TH CONGRESS
3D SESSION

S. 3580

IN THE SENATE OF THE UNITED STATES

MARCH 14 (legislative day, MARCH 4), 1940

Mr. WAGNER introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

---

JURISDICTION OF OFFENSES AND SUITS

SEC. 40. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.

(b) Any criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his or its principal office or place of business.

JURISDICTION OF OFFENSES AND SUITS

SEC. 213. The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder,

and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit, or action to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

[CONFIDENTIAL COMMITTEE PRINT]

MAY 28, 1940

76TH CONGRESS
3D SESSION

S. 3580

IN THE SENATE OF THE UNITED STATES

MARCH 14 (legislative day, MARCH 4), 1940

Mr. WAGNER introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

---

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.

(b) Any criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his or its principal office or place of business.

JURISDICTION OF OFFENSES AND SUITS

SEC. 213. The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, con-

currently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

[CONFIDENTIAL COMMITTEE PRINT]

May 31, 1940

76TH CONGRESS
3D SESSION

S. 3580

IN THE SENATE OF THE UNITED STATES

MARCH 14 (legislative day, MARCH 4), 1940

MR. WAGNER introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

---

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. (a) The provisions of section 25 of the Public Utility Holding Company Act of 1935 are hereby incorporated in this title as though fully set forth herein.

(b) Any criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his or its principal office or place of business.

JURISDICTION OF OFFENSES AND SUITS

SEC. 213. The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, con-

currently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

[CONFIDENTIAL COMMITTEE PRINT]

June 4, 1940

76TH CONGRESS
3D SESSION

S. 3580

IN THE SENATE OF THE UNITED STATES

MARCH 14 (legislative day, MARCH 4), 1940

MR. WAGNER introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

---

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district

wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

JURISDICTION OF OFFENSES AND SUITS

SEC. 213. The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

[CONFIDENTIAL COMMITTEE PRINT]

JUNE 6, 1940

76TH CONGRESS
3D SESSION

S. 3580

IN THE SENATE OF THE UNITED STATES

MARCH 14 (legislative day, MARCH 4), 1940

Mr. WAGNER introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

[Omit the part struck through and insert the part printed in italic]

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the

defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

JURISDICTION OF OFFENSES AND SUITS

SEC. ~~213~~ *214*. The district courts of the United States, ~~*the Supreme Court of the District of Columbia,*~~ and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240

of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

Calendar No. 1866

76TH CONGRESS
3D SESSION

S. 4108

[Report No. 1775]

IN THE SENATE OF THE UNITED STATES

JUNE 6 (legislative day, MAY 28), 1940

MR. WAGNER introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

JUNE 6 (legislative day, MAY 28), 1940

Reported by MR. WAGNER, without amendment

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such

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JURISDICTION OF OFFENSES AND SUITS

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76TH CONGRESS
3D SESSION

H. R. 10065

IN THE HOUSE OF REPRESENTATIVES

JUNE 12, 1940

MR. COLE of Maryland introduced the following bill; which was referred to the Committee on Interstate and Foreign Commerce

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JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served

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Union Calendar No. 998

76TH CONGRESS
3D SESSION

H. R. 10065

[Report No. 2639]

IN THE HOUSE OF REPRESENTATIVES

JUNE 12, 1940

MR. COLE of Maryland introduced the following bill; which was referred to the Committee on Interstate and Foreign Commerce

JUNE 18, 1940

Reported with amendments, committed to the Committee of the Whole House on the state of the Union, and ordered to be printed

[Omit the part struck through and insert the part printed in italic]

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder ,and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act

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76TH CONGRESS
3D SESSION

S. 4108

IN THE SENATE OF THE UNITED STATES

JULY 30 (legislative day, JULY 29), 1940

Ordered to lie on the table and to be printed

[There were no changes in the jurisdictional sections of either the Investment Company Act or the Investment Advisers Act in the amendments of July 30, 1940.]

Calendar No. 2111

76TH CONGRESS
3D SESSION

H. R. 10065

IN THE SENATE OF THE UNITED STATES

AUGUST 5, 1940

Read twice and ordered to be placed on the calendar

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of

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[PUBLIC—No. 768—76TH CONGRESS]

[CHAPTER 686—3D SESSION]

[H. R. 10065]

AN ACT

To provide for the registration and regulation of investment companies and investment advisers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered

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MOTION FILED
FEB 1 1979

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS, JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; and MORTGAGE TRUST OF AMERICA,

Petitioners,

vs.

HARRY LEWIS,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Motion for Leave to File Brief Amicus Curiae and Brief Amicus Curiae in Support of Respondent

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January 31, 1979

BORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

In the Supreme Court of the United States

OCTOBER TERM, 1977

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Petitioners,

vs.

HARRY LEWIS,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Motion for Leave to File Brief Amicus Curiae and Brief Amicus Curiae in Support of Respondent

Mary Sullivan, William Shapiro, Fanne Shapiro and Kenneth Batchelor hereby respectfully move for leave to file the attached brief as *amici curiae* in this case. The consent of the attorneys for respondent has been obtained. The consent of attorneys for petitioner Transamerica Mortgage Advisors, Inc. ("TAMA") was requested but refused. The attorneys for the other petitioners indicated that they

would consent to the filing of the brief of the instant *amici* only if counsel for TAMA would so consent.

The interests of Mary Sullivan, William Shapiro, Fanne Shapiro and Kenneth Batchelor in this case arise from the fact that they are the representative plaintiffs in a class action presently pending in the United States District Court for the Northern District of California in which the question whether a private right of action may be implied under the Investment Advisers Act of 1940 (Advisers Act) was answered affirmatively by the trial court. *Sullivan et al. v. Chase Investment Services of Boston, Inc., et al.*, 434 F.Supp. 171 (N.D.Cal. 1977). *See also Sullivan et al. v. Chase Investment Services of Boston, Inc., et al.*, 79 F.R.D. 246 (N.D.Cal. 1978) (class action certified).

These moving parties believe that their interests in *Sullivan* will not adequately be represented by the respondent herein because of substantial differences between the facts alleged to give rise to claims of private civil remedies under the Advisers Act in *Sullivan* as opposed to the instant case. Moreover, the moving parties believe it should be emphasized that their right to sue for damages on the facts alleged in *Sullivan* is consistent with Judge Gurfein's concurring and dissenting opinion in *Abrahamson v. Fleschner*, 568 F.2d 862, 879, 882 n.8 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978) which opinion the petitioners in the instant case have embraced. (Petition for Writ of Certiorari at 5.)

The defendant adviser in the instant case has had only one client, never advertised its services or solicited clients, and never held itself out to the public as an investment adviser. (Brief for Petitioners at 3-4).

In contrast, *Sullivan* involves allegations that an investment adviser induced a nationwide class of more than one

thousand investors by means of fraudulent promotional literature to place under its discretionary investment advisory management portfolios consisting of cash and securities.

For the foregoing reasons, it is believed that the brief which *amici curiae* are requesting permission to file contains a more complete argument on the question whether *fraudulent inducement* to enter into an investment advisory relationship with an investment adviser gives rise to private damage remedies under the Investment Advisers Act of 1940, than will the brief to be filed by respondents herein.

Respectfully submitted,

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COUNSEL FOR *Amici Curiae*,
Mary Sullivan
William Shapiro
Fanne Shapiro
Kenneth Batchelor

January 31, 1979

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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

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Petitioners,

vs.

HARRY LEWIS,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Brief for Amici Curiae in Support of Respondent

STATEMENT OF INTEREST OF AMICI CURIAE

The instant *amici curiae* are the representative plaintiffs in a major securities fraud class action which has been pending before the United States District Court for the Northern District of California since August, 1976. *See Sullivan et al. v. Chase Investment Services of Boston, Inc., et. al.*, 79 F.R.D. 246 (N.D. Cal 1978) (class action certified). The trial court has ruled in *Sullivan* that the class may

recover damages upon proof of violation of § 206 of the Investment Advisers Act of 1940 (Advisers Act). *Sullivan et al. v. Chase Investment Services of Boston, Inc. et al.*, 434 F.Supp. 171 (N.D.Cal. 1977).[1] The *Sullivan* action is, to the knowledge of *amici*, the first and, at this date, the only action asserting claims under the Advisers Act to be certified as a class action by any court.

Sullivan involves the assertion of claims that an investment adviser, Chase Investment Services of Boston, Inc. ("CIS") fraudulently induced a class of more than 1000 investors, who were members of the general public, to place under its discretionary investment advisory management portfolios consisting of cash and securities whose values ranged from $25,000 to $500,000 each.[2] During the period of CIS management these portfolios declined in value by approximately $18 million.[3]

---

1. In so ruling, the district court held that the *Sullivan* plaintiffs' allegations of fraud in connection with the sale of investment advisory services, while stating a claim for relief under the Advisers Act, *did not* state a claim for relief under § 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). 434 F.Supp. at 175-77.

2. The defendant advisers in *Sullivan*, CIS and its parent company, John P. Chase, Inc. ("JPC") have determined that the opening value of portfolios placed under CIS management during the period in question in *Sullivan* averaged approximately $55,000. Evidentiary Summary Submitted by CIS and JPC in Opposition to Plaintiffs' Motion for Class Certification, § 2.3. As the district court noted, even the defendants' figures show that the size of the *Sullivan* class numbers approximately 1000. 79 F.R.D. at 257. Thus the aggregate value of the portfolios affected by the fraud alleged in *Sullivan* is approximately $55 million, at a minimum.

3. The defendant advisers in *Sullivan* calculated the average decline in portfolio value under CIS management. From a random sample of 100 accounts, these defendants found that 90 percent of the accounts opened during the class period declined in value; the loss in value of such accounts averaged almost $20,000. Evidentiary Summary, *supra*, note 2, at § 2.8. Taking the district court's figure of 1000 account-holders for the minimum size of the class and the defendant advisers' data that 90 percent of the account-holders suffered loss under CIS management, the total loss to class members approximates $18 million.

The fraudulent inducement in *Sullivan* consisted of the publication and nationwide dissemination of two "performance charts" which *amici* allege—and which the Securities and Exchange Commission ("SEC") has already found (see Addendum to this brief)—to have grossly exaggerated the past performance of the investment adviser.[4] The fraudulent charts were distributed directly by CIS to members of the public who made inquiries stimulated by advertising or referrals by broker-dealers. The charts were also distributed by CIS to broker-dealers for redistribution to the brokers' clients. CIS, for an advisory fee, managed the customers' portfolios on a discretionary basis. All trades ordered by CIS were executed by the customers' personal broker-dealers, who thereby collected their standard commissions on all trades in CIS-managed accounts.

E.F. Hutton & Co., Inc., Dean Witter & Co., Inc., and Mitchum, Jones & Templeton, the broker dealers who dealt with the named plaintiffs, are also defendants in *Sullivan*. The brokers' liability is premised upon their having acted with scienter in aiding and abetting CIS in the distribution of the fraudulent charts. The district court has certified subclasses of all class members who dealt with these brokers.

Another defendant in *Sullivan* is the Boston law firm of Sullivan & Worcester, which is alleged to have acted with

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4. The two charts purported to compare very excellent CIS performance over designated time intervals with the performance of the Dow Jones Industrial and Composite Averages and the Standard and Poor's 425 Average. The charts gave the impression of depicting the performance of all the growth accounts managed by CIS during the period of time designated. However, the charts actually depicted the results of only five particularly successful accounts out of the many hundreds of accounts managed during the periods purportedly covered by the charts—periods in which the results achieved by most of the CIS growth-oriented accounts were far less favorable than the performance of the five accounts depicted in the charts.

scienter in aiding and abetting CIS by participating in the drafting of the fraudulent promotional material (including the charts) which was disseminated by CIS.

The *Sullivan* class litigation was commenced after the Securities and Exchange Commission issued its Findings and Order Imposing Remedial Sanctions in a proceeding involving CIS, its parent corporation (JPC) and certain CIS officers. The Findings and Order is included in the Addendum to this brief.

The Commission concluded that CIS and two of its officers had "willfully violated and willfully aided and abetted each others' willful violations of the antifraud provisions of the Investment Advisers and Securities Exchange Acts." Addendum at 7 (footnote omitted).

Although the respondents in the SEC proceedings consented to the Order imposing sanctions, the Commission neither sought nor obtained the reimbursement of portfolio losses, commissions or advisory fees for the victims of the CIS fraud. CIS has estimated that advisory fees paid by class members to CIS total approximately $2 million. *Sullivan, supra,* 79 F.R.D. at 263 n.9.

SUMMARY OF ARGUMENT

To the extent determinable from the embryonic record, wholly unsuited to review by this Court, the case at bar involves facts which do not present the type of fraudulent conduct which the Investment Advisers Act was expressly established to prevent. The lack of face-to-face dealings between the adviser and the plaintiff, the lack of direct damage to the person being advised, and the lack of fraudulent inducement to enter into the investment adviser relationship combine to suggest that the writ of *certiorari* should be dismissed as improvidently granted. Indeed, if

petitioners' contentions before the district court and the Ninth Circuit are correct, the issue of private remedies for Advisers Act violations is a *moot* point in this case.

Should the Court reach the merits of the case, the Court should apply the four-pronged test of *Cort v. Ash,* 422 U.S. 66 (1975) to determine the existence of an implied right of action for damages under the Advisers Act. Three of these prongs point directly to implying a private right of action for violation of § 206 of the Advisers Act. The other prong, while less indicative, at least leans in the same direction.

(1) The Advisers Act was unmistakeably enacted especially to benefit clients and prospective clients by protecting them from dishonest and self-dealing advisers. *Securities and Exchange Commission v. Capital Gains Research Bureau,* 375 U.S. 180, 191 (1963), *Abrahamson v. Fleschner,* 568 F.2d 862, 873 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978), *Sullivan v. Chase Investment Services of Boston, Inc.,* 434 F.Supp. 171, 180 (N.D.Cal. 1977).

(2) An implied right of action by clients and prospective clients is not only consistent with the Advisers Act but is necessary to effectuate its underlying purposes in view of the many thousands of advisers subject to the Act's provisions and the limited resources of the Securities and Exchange Commission to monitor those activities and to enforce the Act's mandates.

(3) The regulation of investment advisers is not one traditionally relegated to state law, nor have the states, to any meaningful extent, provided for damage remedies against advisers who defraud their clients. *Sullivan, supra,* at 184. The Advisers Act established federal fiduciary standards for investment advisers, *Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 471 n.11 (1977), which will

go largely unenforced unless private litigants are afforded federally created, compensatory remedies as an adjunct to SEC disciplinary proceedings. As a practical matter, the only effective way to take the profit out of advisory fraud which is perpetrated on a nationwide scale is to provide injured advisory clients with the federal remedies, substantive and procedural, which will allow nationwide federal relief free of the vagaries of state law and the ruinous costs of litigating separate actions on behalf of each states' class of injured clients.

(4) Although the Advisers Act contains an unmistakeable indication that Congress intended private individuals to have some form of relief under the Act, there is very little evidence either to create or deny private damage remedies for Advisers Act violations. *Abrahamson, supra,* at 875; *Sullivan, supra,* at 182.

In sum, the circumstances of the claims of *amici* against their adviser demonstrate that an outright rejection of implied rights of action under the Advisers Act, in any and all circumstances, would be antithetical to the manifest intent of Congress in enacting the Advisers Act. This Court should either dismiss its writ of *certiorari* as improvidently granted, or define the circumstances in which a private right of action for damages under the Advisers Act is to be implied, and remand the instant case for further consideration whether such criteria are met.

ARGUMENT

Amici believe that their claims against a fraudulent investment adviser are substantially different from those at issue in the case at bar and may, accordingly, alert the Court to certain matters presented in *Sullivan,* but not in the case at bar, which may be of controlling significance in

the determination whether a private right of action exists by implication under the Advisers Act. For the reasons to be stated below, *amici* urge this Court either to conclude that the instant writ of *certiorari* should be dismissed as improvidently granted, or, in the event the case is to be heard on the merits, to hold that there is—under certain factual conditions at least—an implied right of action for damages under § 206 of the Advisers Act.

A. The Writ of Certiorari Was Improvidently Granted and Should Be Dismissed.

The case at bar is substantially different from the facts of *Sullivan.* The respondent's complaint does not charge the investment adviser with having fraudulently induced members of the public to place portfolios under its discretionary management. Rather, it alleges that the shareholders in a real estate investment trust were indirectly harmed because of improper administration of the affairs of the investment trust by controlling and affiliated persons and entities. This conduct is claimed to have resulted in an unfair investment advisory contract between the trust and its investment adviser. The complaint also charges various acts of self-dealing and other derelictions by the adviser in the course of its investment management. (A.3-21)

Thus, the instant case involves (1) collusive conduct between the investment adviser and the persons controlling the investment advisee; and (2) malfeasance occurring *after* the establishment of the investment advisory relationship. This case *does not* present the type of fraudulent conduct which the Investment Advisers Act was expressly established to prevent, *i.e.,* fraud committed by the adviser upon clients or prospective clients. *See* pp. 9-12, 18-19, *infra.*

Unlike the case of *Sullivan,* the case at bar involves *none* of the following facts relevant to determination of whether implied private remedies ought in any circumstances to be permitted under the Advisers Act: (1) face-to-face dealing between the investment adviser and the persons who are alleged to have suffered the damage; (2) direct damage to the person or entity being advised; (3) (and most importantly) fraudulent inducement by the investment adviser causing members of the public to entrust their assets to the adviser's management. As petitioners argue herein, Transamerica Mortgage Adviser, Inc. ("TAMA"), the instant defendant adviser, "has never advertised its services, solicited additional clients or held itself out in any way as a public investment adviser." Brief for Petitioners at 3-4.

In addition, it is questionable in the case at bar whether the defendant adviser, TAMA, is in fact an investment adviser at all within the meaning of the Advisers Act (R.250-52, R.357-58), or whether TAMA rendered advice with respect to a "security" as that term is defined by the Advisers Act § 202(a)(18) (R.350-56). TAMA raised these points before the district court and the Court of Appeals, which left them undecided. TAMA has not presented these issues in its petition for *certiorari;* this should not obscure the fact that, on TAMA's own analysis of this case, the question of the existence of a private right of action for damages under the Advisers Act is *moot* because the Advisers Act does not apply to its activities. See also Note 9, *infra.*

That the case at bar does not call into scrutiny the serious question whether members of the general public who are fraudulently induced into establishing an investment advisory relationship have a federal remedy is but the first of the flaws of this case. More serious, perhaps, is the

shabby state of the record below. In the case at bar, there was no written opinion offered below by the district court. The opinion below by the Court of Appeals was quite cursory, relying exclusively upon the majority opinion in *Abrahamson v. Fleschner,* 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978). Moreover the respondent in the instant case might fairly be characterized as an habitual plaintiff. See cases mentioned in Petition for Writ of Certiorari at 6 and n.3.

Amici submit that the cause of justice will be better served by this Court's awaiting a more appropriate case presenting unambiguously, with a fuller factual record and the benefit of careful draftsmanship by the courts below, the important question of what remedies are available to investors who are defrauded by investment advisers in violation of the duties imposed upon such advisers by Congress.

B. The Court Should Find There Is an Implied Right of Action for Damages Under the Advisers Act.

Applying the four-pronged test of *Cort v. Ash,* 422 U.S. 66 (1975), *amici* urge that members of the public who have employed the services of an investment adviser and who have been injured by a violation of § 206 of the Advisers Act have an implied right of action for damages under the Advisers Act.

1. CLIENTS OF INVESTMENT ADVISERS ARE THE CLASS FOR WHOSE ESPECIAL BENEFIT THE STATUTE WAS ENACTED.

As the district court declared in *Sullivan,* 434 F.Supp. at 180:

> Congress enacted the Investment Advisers Act explicitly for the protection of whose who employ investment advisory services:

> "The essential purpose of [the Act] is to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts . . ." H.R. Rep. No. 2639, 76th Cong., 3d Sess. 28 (1940).
>
> "[T]he dangerous potentialities of stock market tipsters imposing upon unsophisticated investors, convinces this committee that protection of investors requires the regulation of investment advisers on a national scale." S. Rep. No. 1775, *supra*, at 21.

The district court went on to conclude that "the Investment Advisers Act . . . is for 'the protection of investors.'" *Id. Accord, Abrahamson v. Fleschner, supra,* 586 F.2d at 873.[5]

The district court in *Sullivan* echoed the prior sentiments of the district court in *Bolger v. Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260, 263 (S.D.N.Y. 1974), where the court concluded that "Congress determined that persons who paid for investment advice needed protection from dishonest and self-dealing advisers," and that "persons who were defrauded out of substantial sums of money by their investment advisers, fall squarely within the class

5. Although *Abrahamson* was decided before the filing of the district court's opinion in *Sullivan*, the *Sullivan* opinion was reasoned and written independently of the Second Circuit's decision in *Abrahamson*. *See* 434 F.Supp. at 179, n.9. Indeed, the *Sullivan* opinion treats the issue of private remedies under § 206 of the Advisers Act at greater length than does the *Abrahamson* majority, and applies the *Cort v. Ash* test with greater rigor, while reaching the same conclusion as does the majority in *Abrahamson*. It is unfortunate that, in dissenting from the Advisers Act portion of *Abrahamson*, Judge Gurfein did not have the benefit of Judge Renfrew's reasoning in *Sullivan*. Judge Gurfein's complaint that the *Abrahamson* majority failed to apply all four *Cort v. Ash* factors with equal rigor, *see* 568 F.2d at 881-82, is patently inapplicable to the careful analysis in *Sullivan* of how a private damage remedy for violation of § 206 of the Advisers Act is consonant with each factor of *Cort v. Ash*, and is compelled by the collective force of the four factors, *see* 434 F.Supp. at 179-184.

of persons whom the anti-fraud provisions of Section 206 [of the Advisers Act] were intended to protect."

Although petitioners herein correctly state that *Bolger* was decided prior to *Cort v. Ash,* Brief for Petitioners at 12 & n.17, they incorrectly state (contrary to the above-quoted passage from *Bolger*) that the *Bolger* court did not consider whether the Advisers Act was adopted for the special benefit of persons defrauded out of money by investment advisers.

The issue as stated by petitioners is whether "The Advisers Act Was Enacted for the Special Benefit of *Investors Seeking Money Damages* for Violations of the Act." Brief for Petitioners at 11 (emphasis added). It appears that petitioners thus mean to contend, with more guile than logic, that *Bolger's* finding that the Advisers Act protects investors who were "defrauded out of substantial sums of money" is unsupportive of the proposition that the Advisers Act was enacted for the benefit of investors who are "seeking money damages for violations of the Act."

Quite apart from utterly failing as a basis for distinguishing *Bolger,* the articulation of the issue in these terms is distinctly conclusory. Like the Mad Hatter serving tea to Alice, petitioners herein propose to allow defrauded investors an *implied* private remedy for damages only when their statutory cup has already been filled by an *express* provision for money damages. Absent such an express remedy, petitioners argue, there is insufficient evidence of intent to protect investors to permit recognition of an implied remedy. Petitioners should return to the other side of the looking-glass of legislative intent.

Petitioners' reasoning appears to be incompatible with the recognition, in *Cort v. Ash,* that in certain circum-

stances the intent of Congress can only be effectuated through implied remedies.

The starting point for this analysis is identification of the intended beneficiaries of statute. In the instant case, reference hardly need extend beyond the words of § 206 of the Advisers Act itself, 15 U.S.C. § 80b-6: "It shall be unlawful for any investment adviser . . . to employ any device, scheme or artifice to defraud [or] to engage in any transaction, practice, or course of business which operates as a fraud or deceit *upon any client or prospective client.*" (Emphasis added.) And indeed, this Court has already ruled that these very words were intended by Congress to be given "a broad and *remedial* construction." *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.* 375 U.S. 180, 185-195 (1963) (emphasis added).

Amici submit that it is beyond serious dispute that members of the public who are defrauded by investment advisers were intended to be the especial beneficiaries of § 206 of the Advisers Act.

2. THERE IS NO INDICATION OF CONGRESSIONAL INTENT TO DENY AN IMPLIED RIGHT OF ACTION FOR DAMAGES.

The district court in *Sullivan* rejected, after extensive consideration, the argument that the absence of "actions at law" language in § 214 of the Advisers Act indicates an intent by Congress not to allow private damage actions. 434 F.Supp. at 180-82. The *Sullivan* court concluded that "§ 214 casts no light on whether Congress would have approved or disapproved of an implied right of action under § 206." *Id.* at 182.

However, the *Sullivan* court did find evidence of Congressional intent supportive of private remedies in the language of Advisers Act § 215, which provides that any contract made in violation of the Act "shall be void." This

was found in *Sullivan* to be an unmistakable indication that "Congress intended private individuals to seek at least *some* form of private remedy under the Act." 434 F.Supp. at 182 (emphasis added).

This "shall be void" provision would be manifestly impotent if the absence of *any* private remedy under the Advisers Act reduced it to a statutory affirmative defense to be asserted in the unlikely event that an investment adviser who fraudulently induces a client to enter into an investment advisory contract, later sues the client on the contract. Indeed, it was the seeming inanity of giving such a construction to the parallel provision of the Securities Exchange Act of 1934 ("Exchange Act"), § 29(b), 15 U.S.C. § 78(cc)(b), which impelled the court to imply a private right of action for violation of Rule 10b-5 in *Kardon v. National Gypsum Co.*, 69 F.Supp. 512, 514 (E.D.Pa. 1946), the tap root for all subsequent cases recognizing implied rights of action under New Deal Securities acts. *See* 3 Loss, *Securities Regulation*, 1761-63 (2d ed. 1961).

Indeed, even Judge Gurfein, in dissenting from the *Abrahamson* majority's implication of a private right of action for damages under § 206 of the Advisers Act because of his construction of § 214 as disallowing any such action *at law* for damages, was willing to concede that §§ 214 and 215 could be harmonized by permitting a private action for *equitable* remedies such as rescission and restitution—remedies which, *inter alia*, are sought by the *Sullivan* plaintiffs. In the words of Judge Gurfein, "implication of a private right of action for rescission and restitution under § 215(b) would be well within the jurisdictional grant of § 214, and consistent with the notion that it is only *actions at law* which are inconsistent with the statutory scheme." 568 F.2d at 882 n.8 (emphasis in original).

As with the first prong of the *Cort v. Ash* test for implied statutory remedies, petitioners bend the second prong into a tautology. Petitioners claim to have won the point by purporting to demonstrate that there is no "clear" (Brief for Petitioners at 14) indication of Congressional intent to provide injured clients of investment advisers with a damages remedy. Of course, the clearest indication of Congressional intent would be provision of an express remedy. But if this were the test, *Cort v. Ash* would be a superfluous exercise in the dynamics of the judicial construction of statutes.

As support for the tautological proposition that only "clear" evidence of intent to create a remedy will permit implication of a remedy, petitioners ignore *Cort v. Ash* and turn instead to distorted excerpts from the pre-*Cort v. Ash* cases of *National Railroad Passenger Corp. v. National Ass'n of Railroad Passengers,* 414 U.S. 453, 458 (1974) (*"Amtrak"*), and *Securities Investor Protection Corp. v. Barbour,* 421 U.S. 412, 419 (1975). See Brief for Petitioners at 14, 20-21. In *Amtrak,* this Court invoked the "frequently stated principle of statutory construction" that the express provision of certain remedies in a statute—in that case both a public cause of action and an express, but narrowly circumscribed, private cause of action—should be taken as an implied negation of any further means of enforcing that statute. 414 U.S. at 458. However, this Court qualified the application of that canon of construction by observing that "even the most basic general principles of statutory construction must yield to clear contrary evidence of legislative intent," *id.,* and went on to review the legislative history of the Amtrak Act in question. In both *Amtrak* and *Barbour* (which tracked the *Amtrak* analysis), the legislative history was found to be "clear[ly] incompatible with . . . an implied right [of action]." *Barbour,* 421 U.S. at 421.

Against this background was written Mr. Justice Brennan's opinion for a unanimous Court in *Cort v. Ash.* Mr. Justice Brennan made it clear that the second prong of the *Cort v. Ash* analysis, which looks for "any indication of legislative intent, explicit or implicit, either to create [a private] remedy or to deny one," 422 U.S. at 78, was meant to dispel any inference in *Amtrak* that express evidence of Congressional intent was required if private remedies were to be implied in an act which provided any express remedies at all. "True," wrote Mr. Justice Brennan, "in situations in which it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private cause of action, although an explicit purpose to *deny* such cause of action would be controlling." 422 U.S. at 82 (emphasis in original). Mr. Justice Brennan added a lengthy footnote to drive this point home, specifically declaring the construction of *Amtrak* adopted by petitioners herein, under which there arises an inference of Congressional intent to deny implied private remedies if a statute contains any express remedies at all to be an "entirely unilluminating" "excursion into extrapolation of legislative intent." 422 U.S. at 82 n. 14.

There should, at this time, be no doubt on this issue. Under the controlling principles of *Cort v. Ash,* the second prong looks for any evidence in the legislative history of an intent either to create or deny private remedies, but in no way demands as a condition precedent to further analysis some affirmative showing of legislative intent to create private remedies. The second prong of *Cort v. Ash* is dispositive only when the review of legislative history shows, as in *Amtrak,* "specific support . . . for the proposition that the statutory remedies were to be exclusive." *Cort v.*

Ash, 422 U.S. at 82 n. 14, citing *Amtrak,* 414 U.S. at 458-461.

As petitioners appear to recognize, there is very little evidence of Congressional intent either to create or to deny private damage remedies for Advisers Act violations. See Brief for petitioners at 20-21. Petitioners pursue two strategies in an attempt to demonstrate some shred of legislative intent antagonistic to such remedies. First, petitioners rely on the omission from § 214 of a jurisdictional provision for "actions at law," and see this as combining with the lack of any express provision for civil damages by the Advisers Act to provide evidence of Congressional disinclination to allow private remedies. As authority, petitioners invoke Judge Gurfein's opinion in *Abrahamson,* which ignores *Cort v. Ash* on this point and instead applies the very interpretation of *Amtrak* which *Cort v. Ash* unanimously disapproved. See *Abrahamson v. Fleschner, supra,* 568 F.2d at 882-83 (separate opinion).

Petitioners fail to account for the majority opinion in *Abrahamson,* which properly found the second prong of *Cort v. Ash* to bend neither for nor against implication of a private remedy because "it is clear that Congress simply did not consider the matter." 568 F.2d at 875. *Accord, Wilson v. First Houston Investment Corp.,* 566 F.2d 1235, 1240-42 (5th Cir. 1978). Petitioners also ignore the plenary consideration of this very point in Judge Renfrew's *Sullivan* opinion, 434 F.Supp. 180-82 & n. 16, which concludes in the same vein as the *Abrahamson* majority that the language and legislative history of the Advisers Act is inconclusive as to Congressional approval or disapproval of private remedies.[6]

6. This is also the conclusion of the editors of the Michigan Law Review, see Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich.L.Rev. 308, 316-20 (1975), which petitioners cite as if it were supportive of their purported discovery of legislative intent antithetical to private remedies under the Advisers Act. See Brief for Petitioners at 16 & n. 23. In fact, the Michigan Note provides detailed and scholarly support for the proposition that "an examination of section 206 in light of [*Cort v. Ash's*] four factors clearly suggests that courts should imply private rights of action in favor of those injured by its violation," 74 Mich.L.Rev. at 314, and concludes that "[t]he similarities between section 206 and rule 10b-5 and the need for private enforcement of section 206 to supplement SEC efforts strongly recommend the judicial implication of a cause of action under that provision," *id.* at 348.

The second strategy which petitioners pursue to construct evidence of Congressional intent where none in fact exists is to point to the failure of Congress to amend the Advisers Act to insert a private right of action for damages. Petitioners admit that such an endeavor leaves them "not unmindful of the limits inherent in 'mute intermediate legislative maneuvers.'" Brief for Petitioners at 20. And well they might be abashed, for this Court has expressly declared, in the exact context of the interpretation of the Advisers Act and the effect of subsequent amendments on the construction of unamended portions, that "the intent of Congress must be culled from the events surrounding the passage of the 1940 legislation. '[O]pinions attributed to a Congress twenty years after the event cannot be considered evidence of the intent of the Congress in 1940.'" *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 199-200.

Moreover, as a matter of logic, quite apart from the impropriety of looking to subsequent Congresses for evidence of the intent of an earlier enactment, the failure of Congress to supply a private remedy by amendment seems more indicative of the pre-existing availability of an implied private remedy under a sound construction of the original text of the Advisers Act, than of the contrary.

Amici conclude that there is inconclusive evidence of an intent on the part of Congress either to create or to deny an implied right of action for damages under the Advisers Act. The language of § 215 of the Advisers Act, providing that contracts violative of the Act "shall be void," is certainly suggestive of an intent to allow equitable remedies to private persons harmed by violations of the Advisers Act, and since the award of a restitutionary measure of damages is but a species of the equitable remedy of rescission and restitution, see Jacobs, *The Measure of Damages in Rule 10-b5 Cases,* 65 Geo.L.J. 1093, 1109-1120 (1977), this suggestion provides some support for implication of a private right of action for damages. But this makes the second prong of *Cort v. Ash* only lean in the direction advocated by *amici,* and makes the analysis of the applicability of the third prong of *Cort v. Ash* particularly crucial.

3. AN IMPLIED RIGHT OF ACTION IS CONSISTENT WITH—AND NECESSARY TO EFFECTUATE—THE UNDERLYING PURPOSES OF THE ADVISERS ACT.

As this Court has already noted in *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 189-90, the "declaration of policy", accompanying the original bill which, with some changes, became the Investment Advisers Act of 1940 stated in pertinent part:

> "[I]t is hereby declared that the national public interest and the interest of investors are adversely affected—. . . (4) when the business of investment advisers is conducted so as to defraud or mislead investors. . . .
>
> "It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to *mitigate and,* so far as is presently practicable to *eliminate* the abuses enumerated in this section." (Citing to S.3580, 76th Cong. 3d Sess., § 202; emphasis added.)

The major abuse addressed by the Act was adviser fraud. "The broad proscription against 'any practice . . . which operates . . . as a fraud or deceit upon any client or prospective client' remained in the bill from beginning to end." 375 U.S. at 191.

The Advisers Act, being the "last in a series of Acts designed to eliminate certain abuses in the securities industry" was, along with the other securities acts, designed "to achieve a high standard of business ethics in the securities industry." 375 U.S. at 186.

Other courts have echoed this Court's views on the purpose of the Advisers Act. The majority in *Abrahamson v. Fleschner, supra,* found that "the purpose of the Advisers Act was to 'protect the public and investors against malpractice by persons paid for advising others about securities'" (citing to S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960)). 568 F.2d at 873. The district court in *Sullivan* concluded that § 206 was enacted for the purpose of the protection of investors. 434 F.Supp. at 183. Finally, the majority in *Wilson v. First Houston Investment Corp., supra,* concluded that "Congress sought to protect investors from the "'problems and abuses of investment advisory services' by regulation of the industry." 566 F.2d at 1242.

The implication of a private right of action for persons damaged by violations of the Advisers Act is both *consistent with* and *necessary* "to make effective the [above-stated] congressional purpose" underlying the Advisers Act. *J. I. Case Co. v. Borak,* 377 U.S. 426, 433 (1964).

Unlike the situation in *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), the implication of a private damage remedy *would* confer an "advantage on the expressly protected class" whose welfare motivated Congress to pass the Advisers Act. 430 U.S. at 38. Unlike *Piper, supra,* the plaintiff in the instant case is not a person "whose conduct the statute is designed to regulate." 430 U.S. at 39. Also unlike the situation in *Piper, supra,* the plaintiff seeking damages under the Advisers Act will not typically be a corporate giant proposing to acquire by litigation what it could not acquire in the marketplace. Although the instant case does involve a corporate investment advisory client, the *Sullivan* case demonstrates that the rights to recovery of many small investors hang in the balance of the Court's decision herein.

Even if the third prong of the *Cort* test poses the questions whether a private right of action would be not only "consistent" with a statute's underlying legislative purpose but also "necessary" to effectuate those purposes, *see Sullivan,* 434 F.Supp. at 182 n. 17, *amici* submit that an implied right of action for damages is, as the district court in *Sullivan* found, "both consistent with and necessary to achieving Congress's underlying purpose in enacting the Investment Advisers Act." *Id.*

This Court in *J. I. Case Co. v. Borak, supra,* allowed private enforcement of the proxy rules as "a necessary supplement to Commission action." 377 U.S. at 432. One of the Court's considerations was that the Securities and Exchange Commission "examines over two thousand proxy statement annually and each of them must necessarily be expedited." *Id.* at 432.

Similar considerations apply to provide enforcement of the Advisers Act. The district court in *Sullivan* found that as of December 31, 1976, 4,328 investment advisers were

registered with the Commission. 434 F.Supp. at 183. Given that § 206 of the Investment Advisers Act appears to apply to *unregistered*[7] as well as registered investment advisers and that promotional materials to be used by registered investment advisers do not even have to be submitted to the Commission (as do proxy statements), there is an imperative need to supplement Commission enforcement of § 206 of the Advisers Act with the deterrent prospect of private damages actions.

As the history of the *Sullivan* case shows, it is virtually impossible for the Commission to enforce § 206 of the Advisers Act until after the offense occurs. The limited nature of the Commission's resources results in few litigated cases; of these few, most are settled by means of consent decrees enjoining future violations. Such enforcement proceedings are prophylactic without in any sense being remedial. While certainly helpful to effectuate the purposes of the Advisers Act, their result is to leave the wrongdoers warmly wrapped in their ill-gotten gains while providing no comfort to those who have been fleeced prior to the initiation of the Commission action. As the district court in *Sullivan* noted, "private damage actions may be the only way injured investors can recover money they have lost to dishonest investment advisers." 434 F.Supp. at 183.[8]

The majority in *Abrahamson v. Fleschner, supra,* expressed the same sentiment by declaring that "the courts consistently have recognized that the Commission's resources are inadequate to the task of policing alone the federal securities laws" as a basis for concluding that

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7. Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act, supra* note 6, at 311 n. 18.

8. The plaintiff class in *Sullivan,* without a private remedy, will be unable to recover the millions of dollars in advisory fees and brokerage commissions generated by their adviser's alleged violations of the Advisers Act.

"[f]ailure to recognize a private right of action under the Advisers Act would effectively frustrate [its] purpose[s]." 568 F.2d at 874.

The contrast between the policing of the Amtrak system as described in *National Railroad Passenger Corp. v. National Association of Railroad Passengers,* 414 U.S. 453 (1974) and the policing of thousands of registered and unregistered investment advisers to enforce the duties and obligations imposed by Congressional legislation is significant. The Amtrak system is subject to "substantial scrutiny . . . by both Congress and the Executive". 414 U.S. at 464. Clothing the Attorney General with the exclusive power to enforce the Amtrak Act (except in cases involving labor agreements) was found by this Court to have been considered by Congress to be a sufficient enforcement mechanism to police Amtrak obligations under the Act. Yet the sheer numbers and wide-ranging activities of investment advisers and the lack of "substantial scrutiny" of them are strong reasons for supplementing Commission enforcement activity by private remedies.

Moreover, public enforcement of the Amtrak Act appears much more preferable in view of the millions of railroad passengers who might bring suit were a private remedy available. Violations of § 206 of the Advisers Act damages far fewer people far more directly, and private enforcement is, therefore, much more feasible.

As Mr. Justice Stevens wrote in his dissenting opinion in *Piper, supra,* "it is fundamental in our adversary system that the selfish interest of the litigant provides the best guarantee that a claim will be effectively asserted." 430 U.S. at 62. He went on in a footnote to point out that "'there is no policeman so effective as the one whose pocketbook is affected by the degree to which he enforces the law'" *id.* at 62 n.14.

If preventing fraud by investment advisers is, as petitioners have grudgingly conceded, Brief for Petitioners at 23-24, a main purpose of the Advisers Act, recovery of money damages is the only way that § 206 can be expected to achieve its purposes with reasonable certainty and consistency—purposes which are *remedial* as well as prophylactic. By taking the profit out of completed advisory fraud, a private right of action for damages caused by violation of § 206 will effectuate both important purposes.

4. THE CAUSE OF ACTION IS NOT ONE TRADITIONALLY RELEGATED TO STATE LAW.

This Court recognized in *Capital Gains, supra,* "the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities." 375 U.S. at 194.

At the time the Advisers Act was enacted, the investment advisory industry was a "fledgling profession." *Capital Gains, supra,* 375 U.S. at 191 n.34. One of the fundamental purposes of the Advisers Act, as well as the other securities acts, "was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *Capital Gains, supra,* 375 U.S. at 186. The "philosophy of *caveat emptor*" is, of course, the philosophy of the common law which the Advisers Act was meant to change.

It is now beyond cavil that "Congress intended the Investment Advisers Act to establish *federal* fiduciary standards for investment advisers." *Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 471 n.11 (1977) (emphasis added). Given that it is a breach of a *federal* fiduciary duty which is before this Court, it is "for federal courts to fashion federal law where federal rights are concerned." *Textile*

Workers Union of America v. Lincoln Mills of Alabama, 353 U.S. 448, 457 (1957).

The implication of a private remedy which the SEC believes would be "a valuable adjunct to Commission enforcement", *Sullivan,* 434 F.Supp. at 183, is not in conflict with the concern of *Cort v. Ash* over supplanting "whatever remedy is created by state law." *Cort v. Ash, supra,* 422 U.S. at 84.

There is an almost total absence of state laws providing private remedies against investment advisers. The district court found at the time of its opinion in *Sullivan* that "[a]lthough 27 states now have anti-fraud statutes regulating investment advisers, most were enacted well after 1940, and only one provides for a private cause of action." [Citing H.R. Doc. No. 477, 76th Cong. 2d Sess. at 31-33 (1939) and Note. *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich.L.Rev. 308, 324 & n.103 (state statutes collected).] 434 F.Supp. at 184.

Unlike the fact pattern in *Santa Fe Industries, Inc. v. Green, supra,* the extension of the Investment Advisers Act to provide a private remedy would not "overlap and quite possibly interfere with state . . . law." 430 U.S. at 479. There is no need, as would have been the case in *Santa Fe Industries, supra,* "to federalize [a] substantial portion of [state] law [so that] established state policies . . . would be overriden." 430 U.S. at 479.

Even assuming there exist state remedies available which approach the flexibility of the federal standards of advisory fraud as explicated in *Capital Gains, supra,* or which are consonant with the federal fiduciary duties of investment advisors, only the aggregation of resources possible through a nation-wide class action make litigation to redress nationwide advisory fraud practicable. No state cause of action

can be litigated on a nation-wide basis. Yet, a nation-wide class is essential for effective redress of nation-wide securities fraud. This was the approach taken by the district court in *Sullivan, supra,* in which the court found that "Congress unquestionably intended the Investment Advisers Act to provide 'regulation of investment advisers on a national scale . . . [T]he solution of the problems and abuses of investment advisory services . . . cannot be effected without federal legislation'" (citing to S. Rep. No. 1775, 76th Cong., 3d Sess. at 21 (1940)). 434 F.Supp. at 184.

The vagaries of state law are ill-equipped to provide relief to those who have been ensnared by investment advisory fraud. The Advisers Act recognizes this, and provides both standards of care and the prospects of effective redress.

CONCLUSION

Those of the investing public who are least able to fend for themselves seek the seemingly safer haven offered by investment advisers. Investment advisers who commit nationwide fraud in soliciting clients can no more effectively be held to account for damages under state law alone than can those who fraudulently purchase or sell securities. There is no basis in law or reason for advisers to have more freedom to commit fraud in the securities marketplace than broker-dealers. This Court has already construed the Advisers Act as the last Congressional arrow aimed at the dragon of *caveat emptor. Securities and Exchange Commission v. Capital Gains Research Bureau, supra,* 375 U.S. at 186. If this Court holds there is no private remedy for violation of the Advisers Act, that Act will be an arrow without a point. The dragon of *caveat*

emptor will be free to prowl again, and investment advisory clients will surely be among its easier prey.

Indeed, it seems the height of irony that, if the judgment below is reversed without due circumspection, investors who display wariness of the market place by seeking investment advice will be more at the mercy of *caveat emptor* than sophisticated investors who are bold enough to deal directly with the market without seeking the security of investment advisers.

Can it really be the intent of Congress that investors fleeced in the impersonal market place are to be clothed in the folds of the private right of action for damages implied under § 10 of the Exchange Act, while investors fleeced in direct, face-to-face dealing with their federally regulated investment advisers are afforded only the cold comfort of an opportunity to complain about their faithless federal fiduciaries to the self-admittedly overburdened SEC?

It is for this Court to effectuate the intent of Congress to protect investors from advisor fraud. To paraphrase Mr. Justice (then Judge) Cardozo, the Advisers Act is "'instinct with an obligation,' imperfectly expressed." *Wood v. Lucy, Lady Duff-Gordon,* 22 N.Y. 88, 90, 118 N.E. 214 (1917). To admit the imperfection of no express private remedy for violation of § 206 is no basis for eviscerating § 206's mandate to investment advisers not "to defraud any client or prospective client." Congress has made the obligation clear; this Court should correct the imperfection of expression by implying the remedy needed to make the obligation meaningful.

Whether or not in this particular case the conduct alleged constitutes "fraud" under § 206, this Court should ensure that where § 206 has indisputably been violated,

"any client or prospective client" harmed thereby has a federal remedy to provide redress. This can best be accomplished by affirming the court below as to the only issue petitioners chose to present on *certiorari,* the basic issue of the existence in an appropriate case of a private right of action under the Advisers Act.[9]

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January 31, 1979

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9. There were several issues raised by the petitioners herein for its review which the Court of Appeals declined to consider and adjudicate prior to trial court consideration. *Lewis v. Transamerica Corp.,* 575 F.2d 237, 238 (9th Cir. 1978), *cert. granted,* ..... U.S. ....., 99 S.Ct. 348 (1978). Any one of those issues might be dispositive of the case at bar without reaching the question whether to imply a private right of action under the Advisers Act.

Addendum

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 449/March 28, 1975

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 11322/March 28, 1975

Admin. Proc. File No. 3-4635

In the Matter of

CHASE INVESTMENT SERVICES
OF BOSTON, INC.
535 Boylston Street
Boston, Massachusetts
(801-7435)

JOHN P. CHASE, INC.
535Boylston Street
Boston, Massachusetts
(801-5995)

JOHN P. CHASE
Wilsondale Street
Dover, Massachusetts

LAWRENCE M. TILTON
Linea Del Cielo
P. O. Box 1841
Rancho Santa Fe, California

JACK W. SWENSON
112 Thunder Road
Sudbury, Massachusetts
(801-10330)

FINDINGS AND ORDER IMPOSING REMEDIAL SANCTIONS

I.

John P. Chase ("Chase") has been in the investment advisory business in Boston for many years.[1] Chase is Chairman of the Board of John P. Chase, Inc. ("JPC"), a registered investment adviser.[2] JPC's clientele consists of institutions and of individuals with accounts of $500,000 or more.[3] JPC has about $475 million under management.

Chase Investment Services of Boston, Inc. ("CIS"), a wholly-owned subsidiary of JPC and itself a registered investment adviser, serves smaller accounts.[4] CIS's minimum account is $25,000. It manages about 480 accounts with aggregate assets of some $18 million.[5] CIS's policies are shaped by its parent, JPC.[6]

1. His attorneys state that "he has been a leader in the financial community for over 42 years."

2. Until April of 1974, Chase was also JPC's chief executive.

3. The present JPC, a wholly owned subsidiary of Continental Investment Corporation (of which Chase is a director and a stockholder), is the successor to another corporation of the same name. References to JPC in this document relate to both the present company and its predecessor.

4. Just as there was an old JPC and a new one, so too there was an old CIS and a new one. The old CIS was called Chase Investment Services, Inc. It did not have the phrase "of Boston" in its name. CIS is used in this document to refer to both companies.

5. CIS's business used to be substantially larger. From the beginning of 1967 to the present CIS managed the accounts of over 2,400 clients. The assets in those accounts totaled over $100 million.
But in 1972, 1973 and 1974, over 1,000 clients cancelled their investment advisory contracts with CIS. Most of them did so after sustaining substantial losses. Until about March of 1973 CIS gave no rebates to clients who cancelled before the end of the period covered by the fee that they had already paid.

6. Chase is CIS's treasurer and also serves on its Board of Directors.

Lawrence M. Tilton and Jack W. Swenson were formerly associated with CIS and JPC. Tilton was CIS's president and directed the effort to market its services. He was also a vice president of JPC. Swenson, CIS's chief portfolio manager, was also its executive vice president as well as a vice president of JPC. Swenson recently entered the investment advisory business on his own account as a sole proprietor. Accordingly, he is now himself a registered investment adviser.

II.

To determine whether certain allegations about the above-named respondents are true and what remedial action, if any, ought to be taken, this proceeding was instituted under the Investment Advisers and Securities Exchange Acts. Solely for the purpose of disposing of this matter and without admitting or denying the allegations in the order for proceedings, Chase, CIS, JPC, Tilton and Swenson have made offers of settlement. The Commission's staff recommends that those offers of settlement be accepted. And the Commission has decided to do so.

No evidentiary hearing has been held. The findings made below rest entirely on the allegations in the order for proceedings and on the offers of settlement. Respondents have consented to the sanctions that this order imposes.

III.

CIS offers what it calls professional investment management or investment counsel service. For this it charges an annual fee of 2% of the first $75,000 under management plus lower percentages on those portions of a particular account's assets in excess of that figure.[7] The first year's

7. CIS raised its rates in August of 1970. Up to that time it charged 2% of the first $25,000 under management, 1% of the next $25,000 and one-half of 1% of the next $250,000.

fee is paid at the outset. Subsequent fees are paid semi-annually in advance and are generally deducted from the client's account.

CIS, Swenson, and Tilton represented that CIS:[8]

(A) Gave smaller investors professional investment management and investment counsel tailored to the client's personal requirements;

(B) Provided such smaller investors with a service comparable to that furnished to the wealthy by JPC and other investment counsel firms;

(C) Made what was in effect a daily reappraisal of all factors affecting the particular account; and

(D) Managed accounts flexibility, placing funds in bonds or short-term debt securities when the economic climate was unfavorable so as to establish reserves for the subsequent purchase of equity securities when the outlook for equities became more attractive.

These representations were materially false and misleading. CIS's service was in no way comparable to that provided by JPC. A CIS portfolio manager "supervised" from 300 to 500 accounts. JPC's portfolio managers, on the other hand, generally handled less than 60 accounts.

CIS clients did not get personalized treatment. No inquiry was made about their personal needs, financial requirements, tax situations, and ability to bear risks. And when such information was obtained, it was disregarded. When funds were not placed in equities, cash balances in clients' accounts lay idle and wholly unproductive.

8. With respect to CIS, the period in question runs from at least January 1, 1967 to the present. In Swenson's case the relevant period begins no later than January 1, 1967 and ends in July of 1974. In Tilton's case the relevant period runs from at least August 1, 1970 to October 31, 1973.

CIS assigned each client to one of three broad categories.[9] Investment decisions were made for these impersonal categories without regard to either the particular needs of the flesh and blood people in the categories or material changes in CIS's research positions. Thus a CIS client received about as much personal service as he would have gotten from a mutual fund. But the advisory fees and the brokerage commissions that he paid were substantially higher than those that he would have borne had he invested in a mutual fund.

IV.

From May of 1971 to June of 1973, CIS, Tilton, and Swenson represented that CIS had done well for its clients. More specifically, they said that all "growth-oriented" accounts under continuous CIS management in the four years between March 1967 and March 1971 had increased by an average of 89.7%. When that four year period was extended to a fifth year, the results became even more enticing. For the five years ending in March of 1972 an average increase of 106.6% was claimed.[10]

People were not told that:

(A) These dazzling results reflected the average performance of but five accounts. Even within that extremely limited sample performance varied widely.

(B) No audit of CIS's 1967-1971 investment results had been made.[11]

(C) Both CIS's overall performance and the investment results achieved by most of its growth-oriented accounts were far less favorable for the periods in question.

9. The category in which a person was placed depended on his investment objective.

10. CIS and Tilton claimed that these results had been audited by certified public accountants. Swenson, however, is not found to have done so.

11. See the preceding footnote.

(D) During other periods when CIS had a far larger volume of assets under management, most of its clients lost money.

V.

The fraudulent claims about past results were supplemented by representations that:

(A) CIS's goal for a client who had "maximum capital appreciation" as his objective was to double his money in five years—this goal was realistic; it had actually been achieved in the past.

(B) CIS's professional investment management could reduce the risks of investing.

(C) CIS invested prudently in securities of good quality and did not trade or speculate.

Actually, however, only four of CIS's "maximum capital appreciation" clients had doubled their money in five years. Moreover, CIS's investments were not broadly diversified. They were confined to a limited group of issues, most of which were risky and speculative. Clients were not told this.

Nor were those who stated their objective as maximum capital appreciation warned that they were likely to experience fluctuations significantly greater than those in leading market indicators (such as the Dow Jones Industrial Average) and substantial downside risk.

VI.

CIS relied heavily on referrals from brokers and dealers as a source of new clients.[12] Clients referred to CIS in this

12. It required each client to grant it discretionary authority to buy and sell securities without prior consultation with or comment from him. It also insisted that the client maintain an account with a broker. CIS would then execute all transactions through that broker. In most instances this business went to the broker who had referred the client to CIS in the first place.

way were not told that CIS was inducing brokers to send it business by splitting its advisory fees with the referring brokers.[13] Nor were clients told of another substantial benefit that went to the referring broker. CIS saw to it that referring brokers knew that the typical CIS account had a portfolio turnover of about 100% during the first year and of about 50% thereafter and that the extremely substantial brokerage commissions generated by all this activity would inure to the broker's benefit.[14]

VII.

From the foregoing it follows that:

(A) CIS, Tilton, and Swenson willfully violated and willfully aided and abetted each other's willful violations of the antifraud provisions of the Investment Advisers and Securities Exchange Acts.[15]

13. The kickbacks ranged from 10% to 25% and were not limited to the first year's fees.

14. See n. 12, *supra*.

15. Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act, and Rule 206(4)-1(a) under that statute. Section 10(b) of the Securities Exchange Act and the Commission's Rule 10b-5 thereunder. In addition, CIS willfully violated Section 203(c)(2) of the Investment Advisers Act which makes it unlawful for any registered investment adviser "to represent that he is an investment counsel or to use the name 'investment counsel' as descriptive of his business unless . . . a substantial part of his or its business consists of rendering investment supervisory services." The term "investment supervisory services" is defined in Section 202(a)(13) of the Act as "the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client." As a well-known treatise says, "The criterion for the use of the descriptive term 'investment counsel' is . . . the continuity and personalized nature of the advice . . . ." 2 Loss, Securities Regulation 1413 (2d ed. 1961). It is further found that Tilton and Swenson willfully aided and abetted CIS's willful violations of this section.

(B) JPC and Chase himself failed reasonably to supervise with a view to preventing the aforementioned violations.[16]

VIII.

The Commission's conclusion that the sanctions to which the respondents have consented are sufficient to vindicate the public interest and appropriate for the protection of investors was influenced by CIS's undertaking—joined in by JPC--to:

(A) Develop standards and procedures to assure each investment advisory client of personalized treatment;[17]

(B) Deliver a written statement to prospective clients disclosing all material facts about CIS's advisory service, including CIS's investment methods, the risks inherent in those methods as well as the risks incident to any form of investment in securities, personnel, sources of research, and means and methods of executing brokerage transactions.

16. They thus violated Section 203(e)(5) of the Investment Advisers Act.

17. This will involve:
(i) Obtaining information about the client's needs and investment objectives;
(ii) Affording the client an opportunity to discuss this information.
(iii) Having reasonable grounds to consider the service suitable to the particular prospect's needs;
(iv) Having reasonable grounds to believe that investment decisions are suitable to the client's particular needs;
(v) Reviewing each client's account on a continuous basis;
(vi) Giving each client reasonable access to his account bearer;
(vi) Giving each client reasonable access to his account manager;
(vi) Establishing minimum with respect to account size and personnel requirements as well as limitations on the number of accounts to permit personalized investment treatment to the client; and
(viii) Providing a procedure for investing the idle cash in clients' accounts in an interest-bearing account or in a security or for withdrawing such cash from CIS' supervision.

(C) Monitor and establish reasonable supervisory controls on sales presentations made by CIS personnel and by other persons on CIS's behalf;

(D) Establish a central file, which will contain a copy of any complaint letter from or on behalf of a CIS client; a memorandum of any complaint received verbally from or on behalf of a CIS client; a copy of any written response by CIS and/or a memorandum of CIS's action in response to the complaint;

(E) Develop other recordkeeping and review practices that will help implement the procedures spoken of in paragraph (C) hereinabove;

(F) Proscribe any fee-splitting arrangements;

(G) Develop other procedures to protect the integrity of CIS's relationship with its clients and to assure CIS's independence from brokers and dealers;

(H) Have the foregoing standards and procedures as well as all sales literature and practices reviewed by counsel;

(I) Submit a memorandum to the Commission's Division of Enforcement containing a detailed description of the new procedures that CIS has established and of the methods by which these procedures will be implemented (this memorandum is to be furnished within 30 days from the date hereof);

(J) Retain an independent consultant, satisfactory to the Commission's Division of Enforcement, who will review CIS's new procedures and their implementation and report his findings to the Commission's Division of Enforcement;[18] and

(K) Preserve all of its books and records and those of its predecessor for five years.

18. This person is to be appointed approximately one year from the date hereof.

Swenson has submitted an undertaking comparable to CIS's with respect to his future conduct as a self-employed investment adviser. He also states that:

> "[F]or a time after the inception of CIS's advisory service, he attempted—within . . . limits . . . — to render personalized treatment to those clients who had initial contact with him. However, as the service grew he was directed by his superiors on a number of occasions to limit personal contact with clients and to restrict his activities to the office management of portfolios."

Tilton states "that since October 31, 1973, he has not engaged in any way in any aspect of the investment advisory or broker-dealer business" and that he "has no present intention to engage in the investment advisory or broker-dealer business." Accordingly, he undertakes neither to register as an investment adviser or a broker-dealer nor to associate himself with any registered investment adviser or broker-dealer.

IX.

Accordingly, It Is Ordered that John F. Chase, Inc., Chase Investment Services of Boston, Inc., Lawrence M. Tilton, and Jack W. Swenson be, and they hereby are, required to do all that they have undertaken to do in their offers of settlement herein and in the undertakings annexed thereto; and it is further

Ordered that John F. Chase, Inc. and Chase Investment Services of Boston, Inc. be, and they hereby are, suspended for the 180 days beginning at the opening of business on March 31, 1975, from soliciting or accepting new investment advisory clients for or on behalf of Chase Investment Services of Boston, Inc.; and it is further

Ordered that Chase Investment Services of Boston, Inc. serve its existing clients at cost during the aforementioned 180-day suspension period; and it is further

Ordered that John P. Chase be, and he hereby is, suspended from associating himself with any investment adviser for the 30 days beginning at the opening of business on March 31, 1975; and it is further

Ordered that the registration of Jack W. Swenson as an investment adviser be, and the same hereby is, suspended for the 30 days beginning at the opening of business on April 16, 1975; and it is further

Ordered that the said Jack W. Swenson be, and he hereby is, suspended from association with any investment adviser for the 30 days that will begin at the opening of business on April 16, 1975; and it is further

Ordered that Lawrence M. Tilton refrain from either registering with the Commission as an investment adviser or a broker-dealer or associating himself with any registered investment adviser or any registered broker-dealer without the Commission's prior written approval.

For the Commission by the Office of Opinions and Review, pursuant to delegated authority.

George A. Fitzsimmons
Secretary

By: Shirley E. Hollis
Assistant Secretary